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January 6, 2017

The Honourable Bill Morneau
Minister of Finance
Department of Finance Canada
90 Elgin Street
Ottawa, Ontario
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Dear Minister Morneau,

Budget 2017 – tax policy issues for consideration

Budget 2017 will provide the Government of Canada with an opportunity to improve economic prosperity for Canadians. Although we have long enjoyed a high standard of living relative to most countries, we are currently facing challenges in growing our economy, due in part to the global slowdown in the resource sector. As well, Canada continues to lag many other nations in terms of productivity, one of the most important drivers of prosperity. As discussed in our report series, *The future of productivity*[1], Canada's productivity challenges can be attributed to a number of factors, including business leader risk aversion, underinvestment in machinery and equipment, lack of risk capital for start-up enterprises, increased competition for global talent and insufficient support for innovation. Based on our recent research report, *The future belongs to the bold: Canada needs more courage*[2], we believe that part of the solution is that companies must cultivate courage to build a more prosperous future for Canada, as more courageous companies grow faster and pursue growth more aggressively.

Canadian tax policy can play an important role in helping Canada to be more productive and globally competitive by creating a tax ecosystem capable of fostering innovation and investment while supporting the objectives of a balanced budget over time along with gradually reducing the level of debt to GDP. The available mix of taxes - corporate, personal and indirect - allows the Government to encourage economic growth through targeted tax incentives or allowances while allocating the tax burden across elements of the economy in a fair and equitable manner.

Canada requires capital that must often be sourced from outside of our borders; fiscal policy should ensure that Canada remains competitive in attracting foreign capital.

Accordingly, to ensure that Canadian business can compete around the world, our policy recommendations for Budget 2017 are summarized in eight broad categories:

1. Protect Canada's competiveness in respect of corporate income tax
2. Provide clear, prospective application of revised Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines
3. Consider the introduction of a patent box model
4. Spur a "start-up economy" with improved financing support

[1] http://www2.deloitte.com/ca/en/misc/litetopicpage.MF-CA-Tags.future-of-productivity.html
[2] https://www2.deloitte.com/ca/en/pages/insights-and-issues/articles/the-future-belongs-to-the-bold-new.html

5. Encourage foreign investment through full refundability of scientific research and experimental development (SR&ED) tax credits
6. Attract and retain the world's most talented people
7. Clarify the definition of Canadian Exploration Expenses
8. Enhance certainty through more efficient tax administration

DELOITTE'S BUDGET 2017 RECOMMENDATIONS

1. Protect Canada's competiveness in respect of corporate income tax

Canada is a relatively small, open economy and has capital needs well beyond that which its residents can provide. However, foreign investors have a broad range of opportunities as to where to invest their capital. As a result, Canada's competiveness in attracting inbound investment must be protected.

We commend the Government for pursuing the OECD/G20 Base Erosion and Profit Shifting (BEPS) project's multilateral treaty negotiations rather than implementing the domestic law anti-treaty shopping proposals that were contained in the previous Government's 2014 budget, which would have unilaterally overridden Canada's tax treaties and adversely impacted Canada's competiveness. The OECD/G20 BEPS Multilateral Instrument (MLI) was released on November 24, 2016. We would encourage the Canadian government to articulate the MLI options that it is proposing to choose and to consult with business regarding those proposed options. The UK and Australian governments have commenced such consultation. In particular, regarding the provisions that relate to treaty-abuse, we would encourage the Government to issue detailed guidance regarding its interpretation of the MLI in that area. Uncertainty in this area may impact inbound investment in Canada.

Canada has, to date, announced adoption of some but not all of the BEPS recommendations. We recommend a measured approach in considering additional measures, taking into account the effect of such measures on competiveness (both in terms of attracting investment and jobs and the potential for success of Canadian headquartered companies relative to foreign peers).

We also recommend the continued monitoring of the competitiveness of Canada's corporate tax rates. Even as BEPS recommendations are being endorsed internationally and plans are under way for their incorporation into national tax regimes, countries are making changes to their corporate tax rates. For example, the United Kingdom announced a gradual reduction in the corporate tax rate to 17 percent by 2020 while the Northern Ireland Assembly intends to reduce the corporate rate in Northern Ireland to 12.5 percent by 2018 to match that of the Republic of Ireland. Likewise, the US Republican party has proposed a reduction of the US corporate rate to 20 percent and President–elect Trump has proposed a reduction to 15 percent.

2. Provide clear, prospective application of revised OECD Transfer Pricing Guidelines

Certainty and clarity in tax law and administration are important to avoid unnecessary disputes, particularly in matters pertaining to transfer pricing, as a lack of certainty may impact cross-border trade. The setting of transfer prices in accordance with the arm's length principle is not a formulaic exercise and, therefore, very often multiple approaches and outcomes are possible with a given fact pattern. This inherently gives rise to difficult controversy and dispute issues. Even though some degree of disagreements between taxpayers and tax authorities cannot be avoided, having a common framework and consistent understanding and application of the OECD Transfer Pricing Guidelines can limit the disagreements to the actual facts at hand. At least, it can eliminate the need to quarrel over which guidance to consult before even considering the technical aspects of a given case.

In this context, we commend the Government for providing clear expectations and timelines for country-by-country (CbC) reporting requirements. The depth of consideration, clarity in guidance, and proactive notification to taxpayers regarding the implementation of CbC reporting requirements should be heralded as the gold standard for enacting changes to Canadian transfer pricing guidance. Canadian taxpayers were given sufficient time to understand and apply the substantial changes stemming from the new OECD guidance contained in the final reports approved by OECD counsel on May 23, 2016 (the "2016 Guidelines") in respect of CbC reporting.

Paradoxically, all other new OECD guidance contained in the 2016 Guidelines has garnered no additional clarity from the Government. Despite the significant new content contained in the 2016 Guidelines, the position communicated in the 2016 federal budget is that the revisions to the Transfer Pricing Guidelines are being applied by the Canada Revenue Agency (CRA) as they are consistent with current practices. However, this assertion that the 2016 Guidelines are consistent with the CRA's current practices is problematic for at least two reasons:

- First, this assertion indicates that even prior to the budget, the CRA had stopped relying on the 2010 version of the OECD Guidelines, in favour of different guidance without any update or notification to the Canadian public about such a policy change. This, despite the fact that the most up-to-date formal policy communication from the CRA on the topic of international guidance, as contained in transfer pricing memorandum TPM-14, was "(i)t is important to note that the CRA endorses the application of the arm's length principle and the 2010 version of the Guidelines for the administration of the Income Tax Act regarding transfer pricing matters". It is our view that a clear transfer pricing memorandum should be drafted and made available to the public before the CRA starts relying on OECD guidance instead of the guidance provided in TPM-14.

- Second, this assertion clearly contradicts the view of Canadian courts which apply the OECD guidelines that were available at the time the transaction was entered into, particularly as noted by the Tax Court of Canada in *Alberta Printed Circuits Ltd. v. The Queen* (2011 TCC 232), where, in reference to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators, the court stated "[t]here was a further update in 2010, but, since this update is well beyond the taxation years in issue, I will refer only to the applicable 1995 Commentary".

Furthermore, the 2016 Guidelines do not offer only CbC reporting requirements and improved interpretations of the arm's length principle, as the budget comments seem to indicate. The value chain analysis described in the 2016 Guidelines are clearly new, additional content that goes beyond a clarification or improved interpretation, and are not described at all in any of the specific comments and draft Canadian legislation in respect of CbC reporting. The 2016 Guidelines content that calls for risk-free returns or risk adjusted returns in certain circumstances, and certain guidance in respect of non-recognition of transactions also deviate materially from the 2010 Guidelines and, in our view, go beyond simple improved interpretations. In addition, we are of the view that the 2016 Guidelines content intended to combat cash boxes and limited functional entities represent special measures that have a potential to go beyond the arm's length principle as stipulated in section 247 of the Income Tax Act).

The decision to apply the 2016 Guidelines retroactively, may create a dichotomy whereby taxpayers will have to choose in some circumstances between following the legislation or following the special OECD measures in the 2016 Guidelines. It is our view that only the aspects of the Guidelines that are truly clarifying in nature should be applied retroactively.

3. Consider the introduction of a patent box model

Global competition to attract research and development (R&D) spending has increased significantly in recent years. Not only are countries adopting or expanding R&D tax incentives to promote such activities, but they are also providing new tax incentives to encourage the commercialization of that R&D. This is outlined in our recent report[3]. These incentives, often referred to as "patent boxes", allow

[3] https://www2.deloitte.com/content/dam/Deloitte/at/Documents/Tax/at-tax-2015-global-survey-of-RD-taxincentives.pdf

corporate income related to the sale of patented products to be taxed at rates which are significantly lower than the rates applied to regular business income. This preferential treatment of intellectual property income is meant to provide firms with a stronger incentive to innovate and commercialize the innovations domestically.[4]

As identified in our productivity series[5], Canada's patent intensity has been poor when compared internationally, despite strong performance in academic research. To encourage companies to commercialize and retain patents in Canada, we recommend that the Government study whether a patent box regime should be implemented in Canada. The House of Commons Standing Committee on Finance, before which Deloitte appeared as a witness, made a similar recommendation in its 2014 pre-budget consultations report.[6] Our country may be at a competitive disadvantage without such a regime, as Canada's trading partners that are also members of the G20 (e.g., the United Kingdom, China and France[7]) are continuing to utilize and support these regimes. Furthermore, based on the October 5, 2015 OECD BEPS report *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance – Action 5: 2015 Final Report*[8], it is clear that patent box regimes will continue to be acceptable tax incentive regimes, in a modified nexus version which requires in-country R&D. In fact, Belgium, Cyprus, Ireland, Italy, the Netherlands, Portugal, Spain, Switzerland and the United Kingdom have recently announced new or revised intellectual property regimes and the US House of Representatives released a new patent box proposal in the summer of 2015. Furthermore, the European Union is also adopting the modified nexus approach as outlined in the BEPS project.

4. Spur a "start-up economy" with improved financing support

In the OECD's report *Supporting Investment in Knowledge Capital, Growth and Innovation*[9], private sector risk capital is recognized as playing a critical role in supporting business growth, innovation and new employment creation. Also, as identified in our productivity series[10], one of the factors contributing to Canada's relatively low productivity is the lack of capital for start-up enterprises. From early seed financing through to initial public offerings, it is our observation that Canada's financing ecosystem does not provide enough support to home-grown enterprises with world-class potential. As a result, start-up firms may not be able to secure financing and may be leaving Canada for jurisdictions where risk capital is more readily available.

We believe that the first priority in enhancing Canada's financing regime should be to improve support for the early stages of innovation when risks are higher, as we have previously noted in our comments[11] on July 27, 2012 to the Department of Finance in response to the Government's request

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[4] R.D. Atkinson and S. M. Andes. "Patent Boxes: Innovation in Tax Policy and Tax Policy for Innovation." The Information Technology & Innovation Foundation Report. October 2011.

[5] http://www2.deloitte.com/ca/en/misc/litetopicpage.MF-CA-Tags.future-of-productivity.html

[6] House of Commons Standing Committee on Finance, "Towards Prosperity: Federal Budgetary Priorities for People, Businesses and Communities," December 2014, http://www.parl.gc.ca/content/hoc/Committee/412/FINA/Reports/RP6830258/finarp08/finarp08-e.pdf.

[7] Other countries with patent box regimes include Belgium, Hungary, Ireland, Liechtenstein, the Netherlands, Spain and Switzerland.

[8] OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance – Action 5: 2015 Final Report* (Paris: OECD, October 2015), http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/countering-harmful-tax-practices-more-effectively-taking-into-account-transparency-and-substance-action-5-2015-final-report_9789264241190-en#page1.

[9] OECD, *Supporting Investment in Knowledge Capital, Growth and Innovation* (Paris: OECD, October 2013), http://www.keepeek.com/Digital-Asset-Management/oecd/industry-and-services/supporting-investment-in-knowledge-capital-growth-and-innovation_9789264193307-en#page1.

[10] Supra note 5.

[11] http://www2.deloitte.com/content/dam/Deloitte/ca/Documents/tax/ca_en_tax_Deloitte_comments_Venture_capital_270712_AODA.PDF

for feedback on the issue of support for venture capital. We strongly recommend the introduction of an angel tax credit. Targeted credits will serve to encourage investing in high-growth small businesses by mitigating the risks associated with these investments. An angel tax credit is the logical starting point for the creation of a sustainable venture capital industry financed by the private sector and it is the incentive that can have the greatest impact on growing our economy.

5. Encourage foreign investment through full refundability of SR&ED tax credits

Innovation is one of the most important contributors to a nation's sustained economic growth and R&D is the lifeblood of innovation. However, companies face many challenges when incorporating innovation into their businesses. Companies need access to a skilled workforce, capital markets, and customers, along with support for business transformation including research and development (R&D). As both people and projects are mobile in the global marketplace, companies have global options to address these challenges. The decision on where to invest will be dependent on many factors, one of which is government support for business innovation. Ensuring that government support for business R&D expenditures is globally competitive is therefore essential.

Governments are competing vigorously for international investment and are seeking opportunities to encourage domestic growth through industrial R&D. More countries are introducing new indirect tax incentives, with 28 out of 35 OECD countries having R&D tax incentives in 2015 compared to only 12 in 1995.[12] In addition, countries with existing programs are enhancing the benefits with increased scope or increased rates from tax credits and deductions as described in our report, *Deloitte 2015 Global Survey of R&D Incentives.*[13] These incentives have become more generous as countries hope to improve competitiveness and stimulate long-term economic growth.[14] In fact, recent studies in the United Kingdom and the United States provide empirical evidence that tax incentives for R&D lead to an increase in R&D spending.[15]

Despite the increase in global support for innovation through policies such as R&D incentives and empirical support for the effectiveness of government incentives, Canada is lagging behind as total government support for R&D has been cut back since 2008. To enhance Canada's global attractiveness and encourage foreign investment, we believe that the SR&ED investment tax credit (ITC) should be made refundable for all corporations carrying on business in Canada, rather than only for certain private companies. In our prior submissions to the Department of Finance [16], we recommended a broad based extension of ITC refundability to all businesses. While we continue to support that goal, in light of the important objective of achieving a balanced budget over time along with gradually reducing the level of debt to GDP, we recommend that the Government consider offering partial refundability to all businesses at this time.

Currently, only qualifying small Canadian-controlled private corporations may claim a refundable credit while all other companies only receive the benefit of the ITCs in years with corporate taxes payable. Long-term planning is made difficult for these organizations, as many operate in cyclical industries and cannot predict the years in which they will have sufficient corporate tax liability to make the SR&ED tax credits of any value. Expanding the refundable credit to all corporations would appropriately reward the risks inherent in performing R&D in Canada.

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[12] OECD Science, Technology and Industry Scoreboard, 2015.

[13] For example, see https://www2.deloitte.com/content/dam/Deloitte/at/Documents/Tax/at-tax-2015-global-survey-of-RD-taxincentives.pdf.

[14] I. Guceri and L. Liu, "Effectiveness of fiscal incentives for R&D: quasi-experimental evidence," Oxford University Centre for Business Taxation, Working paper, 2016.

[15] R. Fowkes, J. Souse and N. Duncan, "Evaluation of Research and Development Tax Credit", HMRC Working Paper, March 2015 and US Treasury Department, Office of Tax Analysis, Research and Experimentation (R&E) Tax Credit, October 12, 2016 (on-line: https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/RE-Credit.pdf).

[16] For example, see https://www2.deloitte.com/content/dam/Deloitte/ca/Documents/tax/ca-en-deloitte-comments-2016-budget-recommendations-AODA.PDF.

An additional issue to consider arises in the case of Canadian companies that are subsidiaries of US parent companies that perform R&D in Canada. If the ITCs were refundable, from a US tax perspective, they would not reduce Canadian tax otherwise payable but rather would reduce the R&D expenditure, resulting in a permanent savings.[17] Presently, since the ITCs are not refundable, although a Canadian subsidiary would benefit from a reduction in the Canadian tax payable, ultimately the parent company's US tax increases when funds are repatriated, due to the operation of US foreign tax credit rules. Thus, for many of these US-based multinationals, refundability means the difference between the incentive being a permanent tax savings and a tax deferral, which can be a powerful distinction in perceived value.

Therefore, we recommend that the Government implement a model of refundability for corporations currently not eligible for refundable ITCs that allows these corporations to earn at least partial refundability if they meet certain requirements. For example, a corporation could receive partial refundability of SR&ED ITCs if it can demonstrate an increase in its labour force over a prior period. This approach would support the creation of employment in an important sector of the Canadian economy, and would align with the Government's goal of increasing the number and types of jobs for Canadians.

We also recommend that the Government reconsider the treatment of capital expenditures under the SR&ED regime. Excluding capital expenditures from the SR&ED regime does not recognize that capital investments are needed to perform R&D and that certain industries are put at a distinct disadvantage as a result. For example, computers and related equipment are often required in order to undertake R&D. Rather than completely exclude all capital costs, we recommend that the Government consider providing for some recognition of the significant capital elements of R&D by, for example, allowing accelerated amortization of capital expenditures used in R&D or reflecting the investment in the proxy amount. Special treatment of R&D of capital expenditures would be in line with other countries such as Australia, France and the United Kingdom.

Furthermore, we recommend that the Government encourage collaborative research between original equipment manufacturers (OEMs) and small and medium-sized enterprises (SMEs). To encourage OEMs to collaborate with SMEs, the Government could allow OEMs to claim the enhanced refundable SR&ED tax credits available to SMEs, but only on specific collaborative projects.

Enhancing the Government's support for innovation through the SR&ED incentive program is a critical step that will allow Canada to be a leader in innovation, both in the knowledge economy and in new technologies designed to exploit energy and resources.

6. Attract and retain the world's most talented people

A key focus must be attracting and retaining the individuals most likely to drive innovation in the economy and improve Canada's productivity. Accordingly, we encourage the Government to focus on monitoring the competitiveness of the personal tax regime, improving immigration policies, encouraging retirement savings, and updating salary deferral arrangement legislation.

Monitor competitiveness of top personal tax rate and threshold

We recognize that the increase in the top personal income tax rate was part of the Government's election platform, and is a current priority. We encourage the Government to monitor the impact of that increase in order to assess whether it is achieving the anticipated results.

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[17] Even delayed refundability (e.g., refunding ITCs if not used within three years) would achieve the U.S. tax benefit with a modest cost to the Government.

We believe that Canada's personal tax rates should be competitive with those of our trading partners (in particular, the United States). Our top rate is now significantly higher than that of most of our global trading partners and the threshold for reaching that top rate is much lower than that of many of those countries. This may discourage immigration to Canada and make it much more expensive for Canadian business to recruit top talent, as tax is one of the factors that will have to be taken into account in establishing competitive remuneration. This could also impede transfers to Canada within multinational organizations by making Canada a less attractive destination for business due to the cost of having to gross-up employee compensation to take into account the higher income tax cost in Canada.

A second concern, to be monitored, is whether or not the increase in rates will actually result in the anticipated increase in revenue for the Government. Recent studies[18] have shown that higher tax rates can motivate individuals to increase their focus on tax planning strategies and may cause a reduction in hours worked, both of which impact government revenue. This issue seems to also be a concern for certain provinces such as New Brunswick which has announced a review of its personal tax rates to determine whether a reduction to the top personal income tax rate is required as a result of the increase in the federal rate. As an alternative to personal income tax rate increases, we believe that there is room to increase consumption taxes, which are low by global standards. An increase in consumption taxes, with appropriate credits for low income families, may provide a less costly and more reliable source of revenue.

The US President-elect is proposing significant reductions in personal tax rates (e.g., reducing the top rate to 33%) while only imposing the top rate of tax at levels of income that are above Canada's highest threshold while maintaining preferential tax rates for capital gains. If these measures are enacted, Canada's competiveness with the US would be diminished.

Increase targeted immigration – meeting Canada's future needs

With Canada's aging population and skills shortage, our country's human capital needs should be articulated in a reasoned and practical multi-year plan aimed at increasing immigration to fill gaps in the Canadian workforce and to support a sound knowledge base. We applaud the Government for already announcing steps to transform Canada's immigration system to ensure that more individuals with necessary skills will have ready access to the appropriate sectors of the Canadian economy. We encourage the Government to continue improving the immigration process by increasing overall targets and sharpening existing programs. It is vital that skill shortages be addressed in an expedient fashion in order to maintain a competitive position in the global marketplace.

Currently, Canada grants the right for an individual who is here on a study permit to receive a work permit for up to three years post-graduation. Although in the past these highly-skilled educated individuals had a direct path to permanent residence, under the express entry regime, they now may have difficulty in obtaining permanent residency. Therefore, there is the real danger of losing an entire generation of qualified, needed applicants.

In addition, the Labour Market Impact Assessment (LMIA) process has become so lengthy and difficult that employers are not participating in the process or when they do, they are receiving refusals. As a result, Canada is losing skilled individuals who could assist in our country's growth and success. Furthermore, employers are "offshoring" in order to avoid this process, which is undesirable.

We recommend that the Government consider reintroducing the federal immigrant investor category with some adjustments to address the shortcomings of the previous version of this category. This

[18] See Kevin Milligan and Michael Smart, "Provincial Taxation of High Incomes: The Effects on Progressivity and Tax Revenue" in *Income Inequality: The Canadian Story* edited by David A. Green, W. Craig Riddell and France St. Hilaire, 2015; and Alexandre Laurin, "Shifting the Federal Tax Burden on the One-Percenters: A Losing Proposition," *C.D. Howe E-brief*, December 3, 2015.

category would aim to have experienced business people immigrate to Canada and contribute to Canada's growth and long-term prosperity by investing in Canada's economy.

Increased immigration to Canada by individuals who are educated, productive and innovative will not only improve the ability of Canadian enterprises to compete globally, but will also enhance government revenues from corporate and personal taxation. A larger population of well paid, skilled individuals will contribute significantly to an increase in the overall amount of personal taxes collected.

Encourage retirement savings – planning for tomorrow

Enhancing Canada's incentives for retirement savings will further improve the attractiveness of Canada to new immigrants. Thus, we recommend that new immigrants be allowed to contribute to their RRSPs in the year that they arrive in Canada. Currently, since earned income is measured on a one year lag basis, new immigrants can only contribute to their RRSPs in the year following their arrival into Canada.

Furthermore, we recommend delaying the age that triggers mandatory minimum withdrawals from registered retirement income funds (RRIF). As discussed in the C.D. Howe report *Outliving Our Savings: Registered Retirement Income Funds Rules Need a Big Update*,[19] life expectancy rates for Canadians have increased but the rules for the age at which mandatory withdrawals are required have not. With people expecting to live longer after retirement and lower returns on investments, RRIF holders are in danger of inadequate tax-deferred savings in their later years. Although the 2015 budget has reduced the required minimum withdrawals requirements, we believe that adjusting the age at which withdrawals are required would help further help solve this problem.

We also recommend that the Government monitor the impact of its decision to reduce the tax-free savings account (TFSA) annual contribution limit to $5,500, on overall retirement savings to ensure that the desired overall impact is in fact being achieved.

We support the Government's concern for adequate retirement savings, and the focus on cooperation with the provinces in this regard. We applaud the Government for reaching an agreement with most of the provinces to gradually expand the Canada Pension Plan over five years starting in 2019. The gradual introduction is welcome given the increased cost to business at a time when the economy is still fragile.

Consider updating salary deferral arrangement legislation

International norms should be considered in assessing whether Canada's salary deferral arrangement limit of three years is adequate. A number of jurisdictions have extended the delay of taxation of deferred compensation to four or five years, to match corporate governance trends which are providing for longer deferrals in order to encourage longer term behavior among executives. Adjusting the salary deferral arrangement limit would help to maintain Canada's competitiveness in attracting top international talent.

7. Clarify the definition of Canadian Exploration Expenses

The definition of Canadian Exploration Expenses (CEE) in the Income Tax Act is extensive, but may require some additional clarity in order to encompass all the steps before production. For instance, CEE include expenses incurred for the purpose of determining the existence, location, extent or quality of a mineral resource in Canada[20] and other expenses for the purpose of bringing a new mine into

[19] W.B.P. Robson and A. Laurin, *Outlining Our Savings: Registered Retirement Income Funds Rules Need a Big Update*, C.D. Howe Institute E-brief (Toronto: C.D. Howe Institute, June 4, 2014), https://www.cdhowe.org/sites/default/files/attachments/research_papers/mixed//e-brief_175.pdf.

[20] Paragraph f of the definition of CEE in subsection 66.1(6) of the Income Tax Act.

production in reasonable commercial quantities.[21] However, many corporations also incur significant expenses between those two essential steps and those expenses are not presently covered in the CEE definition. For example, feasibility studies or any other expenses incurred for the purpose of deciding whether to develop a mine are not considered CEE. As it is particularly difficult to obtain financing for expenses at this exploratory phase, we recommend that the Government expand the definition of the CEE to include these expenses.

8. Enhance certainty through more efficient tax administration

Competitive tax policy requires efficient tax administration. Moreover, certainty in tax law is key to attracting and retaining corporate investment and global talent. The tax community as a whole - revenue authorities, taxpayers and tax advisors - all benefit from a clear understanding of the law at any point in time. In this context, we respectfully offer the following recommendations.

- Administrative red tape and filing complexities should be reduced to create a more competitive business environment. In this regard, we encourage the Government to review the scope, application and administration of the 15 percent withholding requirement under section 105 of the Income Tax Regulations (Regulation 105) applicable to payments made to non-residents in respect of services rendered in Canada. Generally speaking, the purpose of the Regulation 105 withholding requirement is to provide the Government with security in the form of an income tax instalment from a non-resident person who may be liable to income tax in Canada.[22] As currently drafted, Regulation 105 often applies to non-residents who do not maintain a permanent establishment in Canada, and who, therefore, are not taxable in Canada on income by virtue of a bilateral tax treaty. As a consequence, very often Regulation 105 unnecessarily immobilizes foreign investment in Canada, putting Canada at a significant competitive disadvantage in relation to other jurisdictions. In addition, Regulation 105 also results in hardship to Canadian businesses as the foreign enterprise rendering the services will often gross up its fees payable by the Canadian payor to compensate for the withholding requirement, again putting Canadian businesses at a competitive disadvantage. In our view, the Government should adjust the scope of the Regulation 105 security regime and its administration such that its application is more consistent with the widely accepted international tax concept of permanent establishment. We applaud the Government for its efforts on the recent modernization of the Regulation 102 regime with respect to payroll withholding tax of non-resident business travellers in Canada, and encourage the Government to take a similar approach to updating Regulation 105.

- Increased resources for the CRA together with streamlined processes to improve the timely completion of audit activity would enhance the experience of carrying on business in Canada. Resolving stale issues is very resource-intensive for both the administration and taxpayers, given normal labour turnover and the erosion by time of memories. In addition, with the likely introduction of new rules and increased transparency globally as a result of the BEPS project, the volume of tax disputes is likely to increase. As such, increased investment in areas that help to efficiently resolve disputes (e.g., competent authority, advance pricing agreements, mutual agreement procedures, rulings, appeals, voluntary disclosures, the use of technology, etc.) would be welcome.

- We congratulate the CRA for its Framework Agreement with CPA Canada which was announced in December 2014. It creates a cooperative and useful forum to address issues. While this is a step in the right direction, we believe that more can be done to improve the relationship between the CRA, the business community and the broader tax community. We

[21] Paragraph g of the definition of CEE in subsection 66.1(6) of the Income Tax Act.
[22] *Weyerhaeuser Co. v R*, 2007 TCC 65, at para 7.

Note: This version of the letter includes some minor editorial changes to the original submission.

would welcome forums that allow for greater communication between the CRA, the Department of Finance, taxpayers and tax practitioners. Improving communication would enhance certainty and allow for increased efficiency in both compliance with and administration of the tax laws.

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Deloitte is committed to playing a key role in shaping Canada's future. We are grateful for the opportunity to provide our policy recommendations and trust that they will be helpful as you move forward with Budget 2017. We would be happy to meet with you personally or with anyone you suggest from the Ministry of Finance to discuss any of these matters further.

Yours truly,

Deloitte LLP

Deloitte LLP

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National Tax Policy Leader

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