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January 11, 2018

The Honourable William F. Morneau
Minister of Finance
Department of Finance Canada
90 Elgin Street
Ottawa, Ontario
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Dear Minister Morneau,

Budget 2018 – tax policy issues for consideration

We believe that Budget 2018 will provide the Government with an opportunity to drive business performance and improve economic prosperity for all Canadians. While some economic uncertainty is present in Canada along with some global geopolitical uncertainty, the Canadian economy and the global economy are doing well and Canada is leading the G7 in growth. However, more must be done to drive long-term sustainable growth based on continuous innovation and robust productivity performance. Canada must also seek ways to enhance its long-term global competeveness .

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.

As Canada's largest professional services firm, we at Deloitte take our role in helping build a better future for our country seriously. Our recent report, *Bold bets for our country: It's time for deliberate action*[1] points to three initial and crucial areas where Canada needs to have courageous conversations about the choices we face, and the trade-offs we must make to put our country on the path to continued success. The report is part of our multi-year Canada at 175[2] research initiative which outlines Deloitte's vision for the future of our nation's competitiveness, productivity, and prosperity. We encourage the Government to back Canada's current and emerging global champions by concentrating investments in areas of sustainable competitive advantage, accelerate global engagement by helping small- and medium-sized firms go global and investing in a competitive immigration system, and prepare for the coming age of disruption with a new approach to education and training that focuses of lifelong learning.

[1] https://www2.deloitte.com/ca/en/pages/press-releases/articles/bold-bets-for-our-country.html
[2] https://www.canada175.ca/en/about-canada-175

Accordingly, to ensure that Canadian business can compete around the world, our tax policy recommendations for Budget 2018 are summarized in nine broad categories:

1. Consider further adjustments to and legislation of the private corporation proposals
2. Protect Canada's competitiveness in respect of corporate income tax
3. Provide clear, prospective application of revised Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines
4. Consider the introduction of a patent box model
5. Spur a "start-up economy" with improved financing support
6. Incent research and development (R&D) through refundability of scientific research and experimental development (SR&ED) tax credits
7. Attract and retain the world's most talented people
8. Clarify the definition of Canadian Exploration Expenses
9. Enhance certainty through more efficient tax administration

DELOITTE'S BUDGET 2018 TAX POLICY RECOMMENDATIONS

1. Consider further adjustments to and legislation of the private corporation proposals

We appreciate the fact that the Government released the tax on private corporation proposals in the form of a consultation paper. We believe that this approach – which affords stakeholders the opportunity to provide input based on their experience and practical insights – fostered a greater understanding of the issues being addressed and will ultimately help to develop tax policy that will build a stronger more competitive Canadian economy. However, as discussed in our October 2, 2017 submission[3], our view is that a 75-day consultation period for proposals that amount to tax reform was not an appropriate approach. We commend the Government for making adjustments to the proposals in consideration of the consultations received. Despite the adjustments, we continue to have concerns with the proposals and the resulting development of legislation.

The proposals currently under consideration are significant and will have an impact on a very large number of taxpayers. The changes being contemplated are dramatic. They cover a large number of issues and have a compounding effect when analyzed in combination. Our major concerns with the original proposals were discussed in our October 2, 2017 submission. They reflect our careful analysis of the consultation paper and our discussions with our clients across Canada.

Our concerns with the proposals, as they currently stand after the October and December 2017 announcements, are summarized as follows:

- In regard to the income sprinkling amendments, the December release provides positive steps toward a more targeted approach than the original proposals. Furthermore, releasing the Canada Revenue Agency (CRA) guidance and interpretation at the same time as the December amendments was welcome. However, the timing of the release just two weeks before the effective date and just prior to the holiday period is unfortunate. In addition, although the "reasonable"

[3] https://www2.deloitte.com/ca/en/pages/tax/articles/finance-proposals-on-tax-planning-using-private-corporations-deloitte-policy-submission.html

tests have been modified, uncertainty still exists for businesses, as it remains to be seen how the CRA will apply these tests. Overall, this legislation continues to be overly complex.

- For passive investments, the proposed legislation should address the undue burden and complexity that could be caused by tracking multiple pools of earnings, reporting requirements, etc. As many elements of the proposals are complex and are anticipated to lead to significant increases in the cost of compliance for Canadians, we recommend a concerted effort to narrow the application of the provisions to more efficiently target what are considered offensive transactions. We continue to be of the view that the Government should not move forward with this proposal.

- We are encouraged by the Government's intention to consult with stakeholders over the next year in regards to the taxation of capital gains. We recommend a more targeted approach to the new legislation and legislation that avoids retroactivity.

- In general, when introducing any new legislation relating to private corporations, we encourage the Government to avoid undue complexity to provide businesses certainty.

Overall, to ensure Canada's competitive position is maintained, we continue to recommend a full assessment of the impact of the proposals on the competitiveness of Canadian private enterprise.

2. 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. In a highly globalized world, companies are mobile and looking for the best places to do business. 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 and was signed by Canada on June 7, 2017. In Article 7, *Prevention of Treaty Abuse*, which addresses treaty shopping, Canada has at present adopted the principal purpose test (PPT). This provision, while adopted by many countries, will create a lot of uncertainty for business. We would encourage the Government to issue detailed guidance regarding its interpretation of the MLI in this area. Uncertainty in this area may impact inbound investment in Canada. In addition, at present Canada has reserved on Article 7(4). This article provides the competent authorities of governments increased flexibility in applying the PPT. In certain circumstances, this might result in a reduced treaty benefit rather than a complete denial of benefits, if that flexibility is not available. As a result, we would encourage the Government to adopt Article 7(4).

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. Canada's combined federal and provincial corporate tax rate is higher than the OECD average rate.[4] 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 to match that of the Republic of Ireland. Also, in its most recent budget the Dutch government announced a planned gradual reduction of its corporate tax rate to 21 percent from 25 percent. Significantly, the United States has moved from a 35 percent to a 21 percent federal corporate tax rate under the US Tax Reform which was recently passed by Congress and signed into law by the President.

More generally, now that US Tax Reform, which implements significant tax reductions, has been passed, we would recommend that the Government assess the impact that it will have on the competitiveness of Canada's tax regime and resulting economic impact. It is crucial that Canada maintain its competiveness relative to the United States, its largest trading partner.

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

Certainty and clarity in tax law and administration are important to avoid unnecessary disputes. Uncertainty in the administration of transfer pricing guidance is detrimental to the Canadian economy as a lack of certainty may impact cross-border trade, investment flows and affect Canada's competitiveness in general.

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 having some degree of disagreement 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. 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 and explicit details to understand and apply the substantial changes stemming from the new OECD guidance contained in the 2017 edition of the OECD Transfer Pricing Guidelines released by the OECD on July 10, 2017 (the 2017 Guidelines) in respect of CbC reporting.

Paradoxically, all other new OECD guidance contained in the 2017 Guidelines has garnered no additional clarity from the Canadian government. Despite the significant new content contained in the 2017 Guidelines, the position communicated in the 2016 federal budget is that the revisions to the Guidelines are being applied by the CRA as they are consistent with current practices. However, this assertion that the 2017 Guidelines are consistent with the CRA's current practices is problematic for at least two reasons:

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[4] The average statutory corporate tax rate of OECD member countries in 2017 is 24.18 percent.

- 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 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 new 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, 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 2017 Guidelines do not offer only CbC reporting requirements and improved interpretations of the arm's length principle, as the Department of Finance budget comments seem to indicate. The 2017 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 deviate materially from the 2010 Guidelines and, in our view, go beyond simple improved interpretations. In addition, we are of the view that the 2017 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 problems associated with retroactive adoption of the OECD Guidelines as discussed above may be further aggravated as the OECD continues to develop new content that goes beyond improved interpretations of the arm's length principle. For example, work continues on complex transfer pricing issues such as the issues contained in the discussion draft dated May 23, 2017, *Implementation Guidance on Hard-to-Value Intangibles*. New OECD guidance concerning hard-to-value intangibles including the latest discussion draft have measures that go beyond the arm's length standard, including the use of after-the-fact profit information as presumptive evidence about the appropriateness of transfer prices. To avoid an ex post approach, taxpayers must meet difficult documentation expectations considering various possibilities that address the certainty of profit and risk possibilities, and prove that different profit results were due to an unforeseen circumstance. Even if a good faith effort is made, there is much uncertainty concerning how a taxpayer can prove the original valuation properly took into account a particular possibility or that the development that affected profit was unforeseeable.

The decision by the CRA to apply the 2017 Guidelines or ongoing additional new content in development by the OECD retroactively may create a dichotomy where taxpayers will have to choose in some circumstances between following the legislation and existing jurisprudence or following the special OECD measures in the 2017 Guidelines. It is our view that retroactive indiscriminate application of the 2017 Guidelines is inappropriate and the increased guidance from the CRA regarding its interpretation of the 2017 Guidelines is required.

4. Consider the introduction of a patent box model

Global competition to attract 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.[5] These incentives, often referred to as "patent boxes", allow 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.[6]

As identified in our productivity series,[7] 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.[8] 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[9]) are continuing to utilize and support these regimes. Furthermore, based on the October 5, 2015 OECD BEPS final report on Action 5,[10] 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 amongst many other changes, US Tax Reform introduced a form of patent box. Furthermore, the European Union is also adopting the modified nexus approach as outlined in the BEPS project.

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

In the OECD's report *Supporting Investment in Knowledge Capital, Growth and Innovation*, private sector risk capital is recognized as playing a critical role in supporting business growth, innovation and new employment creation.[11] Also, as identified in our productivity series,[12] 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

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[5] https://www2.deloitte.com/us/en/pages/tax/articles/global-survey-of-investment-and-innovation-incentives.html

[6] 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.

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

[8] 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.

[9] Other G20 countries with patent box regimes include Belgium, Hungary, India, Ireland, Italy, Liechtenstein, the Netherlands, South Korea, Spain and Turkey.

[10] 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.

[11] 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.

[12] Supra Note 7.

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[13] on July 27, 2012 to the Department of Finance in response to the Government's request 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 with the greatest potential impact on growing our economy.

6. Incent R&D through 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 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 29 out of 35 OECD countries having R&D tax incentives in 2016 compared to only 12 in 1995.[14] 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 2017 Global Survey of Investment and Innovation Incentives.*[15] These incentives have become more generous as countries hope to improve competitiveness and stimulate long-term economic growth.[16] In fact, research 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.[17]

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

[13] https://www2.deloitte.com/content/dam/Deloitte/ca/Documents/tax/ca_en_tax_Deloitte_comments_Venture_capital_270712_AODA.PDF
[14] OECD, OECD Science, Technology and Industry Scoreboard, 2017 and 2011.
[15] See https://www2.deloitte.com/us/en/pages/tax/articles/global-survey-of-investment-and-innovation-incentives.html.
[16] I. Guceri and L. Liu, "Effectiveness of fiscal incentives for R&D: quasi-experimental evidence," Oxford University Centre for Business Taxation, Working Paper, 2016.
[17] 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 (online: https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/RE-Credit.pdf).

private companies. In our prior submissions to the Department of Finance[18], we recommended a broad based extension of ITC refundability to all businesses. While we continue to support that goal, we acknowledge that full refundability may be costly and may hinder achieving the important objective of a balanced budget over time along with gradually reducing the level of debt to GDP. Therefore, we recommend that at this time the Government implement partial refundability for corporations currently not eligible for refundable ITCs if they meet certain requirements to incent specific behaviours. 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.

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.

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 commend the Government's support of collaborative research between original equipment manufacturers (OEMs) and small and medium-sized enterprises (SMEs) through the business-led innovation "superclusters" announced in the 2017 budget. To further 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.

7. 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

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

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.

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[19] 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. 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.

Under US Tax Reform, among other changes, the top federal personal income tax rate is reduced from 39.6 percent to 37 percent. The income threshold at which this rate applies was increased to US$500,000 (US$600,000 in the case of married couples filing jointly). In addition, the current preferential rates on both capital gains and qualified dividends remain unchanged. As a result, Canada's competiveness with the United States in this area, has been further 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. Although the Government has recently adjusted the

[19] 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.

selection criteria so that there is an increased chance for those who study in Canada and then work to qualify for permanent residence, there is still not the same assured pathway to permanent residence in Canada that there was previously. As a result, Canada may not attract as many young students who can ultimately settle in Canada and make a significant contribution to Canada's economy.

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. The Government has recently introduced a program whereby employers in certain industries, such as the high-tech industries, may not have to advertise in the same way as they did before. As a result, their applications are processed more quickly. However, this only applies to a subset of industries and the employers who do need to meet strict advertising requirements are still faced with a long, cumbersome process. Therefore, 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 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 registered retirement savings plans (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,*[20] 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 consider increasing the limits on tax-deferred retirement savings. As individuals are living longer and are realizing lower returns on their retirement

[20] 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).

investments, the limits on retirement savings on tax savings account, defined contribution plans and RRSPs should be updated to allow individuals to save enough for retirement.[21]

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 behaviour among executives. Adjusting the salary deferral arrangement limit would help to maintain Canada's competitiveness in attracting top international talent.

As part of the Government's focus on attracting talented individuals, we recommend that the exemption from the salary deferral arrangement rules for foreign plans set out in subsection 6(13) of the Income Tax Act (Act) be extended from three years to five years. This will align this provision with the duration of the exemption for foreign pension plans from the provisions of the Act regarding retirement compensation arrangements and other provisions of the Act relating to immigrant taxation.[22]

8. 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[23] and other expenses for the purpose of bringing a new mine into production in reasonable commercial quantities.[24] 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.

9. Enhance certainty through more efficient tax administration

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[21] W.B. P. Robson, *Rethinking Limits on Tax-Deferred Retirement Savings in Canada,* C.D. Howe Institute Commentary No. 495 (Toronto: C.D. Howe Institute, November 7, 2017).
[22] These provisions include the exemption from the non-resident trust rules for trusts governed by an employee benefit plan where no participant currently accumulating benefits has resided in Canada for more than 60 out of the last 72 months and certain other requirements are satisfied. As another example, the treatment of assets under the deemed disposition provisions set out in section 128.1 of the Act can vary considerably depending on whether or not the taxpayer has resided in Canada for more than 60 out of the last 120 months.
[23] Paragraph (f) of the definition of CEE in subsection 66.1(6) of the Income Tax Act.
[24] Paragraph (g) of the definition of CEE in subsection 66.1(6) of the Income Tax Act.

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. 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.[25] 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 an income 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 travelers in Canada, and encourage the Government to take a similar approach to updating Regulation 105.

    - Monitor the effectiveness of the new limitations that have been introduced into the Voluntary Disclosure Program. We remain concerned about the new limitations. However, we were pleased that some of the recommendations we made in our submission[26] of August 4, 2017 were incorporated into the final version of "IC00-1R6 Voluntary Disclosures Program" which was released on December 15, 2017.

- 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 of memories over time. 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

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[25] *Weyerhaeuser Co. v R*, 2007 TCC 65, at para 7.
[26]https://www2.deloitte.com/content/dam/Deloitte/ca/Documents/tax/ca_en_tax_Deloitte_Comments_on_VDP_AODA.pdf.

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 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 2018. 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,

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