CANADIANS FOR TAX FAIRNESS
CANADIENS POUR UNE FISCALITÉ ÉQUITABLE

How to Raise More Revenue for Bolder Policy Initiatives

Brief to House of Commons Finance Committee

Pre-Budget Consultations in Advance of the 2018 Budget

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Executive Summary: More revenue is needed for the government to take bolder measures on child care, climate change and poverty. Over $23 billion could be raised by closing unfair and ineffective tax loopholes, curbing corporate offshore tax dodging and Taxing foreign-based E-commerce Companies to Level the Playing Field.

1. Bolder Policy Responses Need More Revenue

A shortage of revenue has seriously curtailed the government's ability to make investments at a sufficient scale and in a timely enough manner to generate a significant economic, environmental and social impact.

While funding in the 2017 Federal Budget for a national child care program, public transit and climate change are a step in the right direction, they are baby steps, that will not have a very large economic, environmental or social impact.

One of the most effective ways to increase productivity and grow the Canadian economy would be to increase the labour force participation rate by investing in a national affordable quality child care program. The IMF is recommending that Canada spend $8 billion a year – not $7.5 billion over 11 years as the Federal Budget 2017 committed. Much of the investment would be recovered in additional revenue from more parents working and paying taxes.

Another key area for boosting the economy and creating jobs is the green tech and public transit sectors. But the $3.1 billion over five years for clean technology and $8.4 billion over five years for green infrastructure and public transit in the 2017 Federal Budget is less than a fifth of what is needed if we are to get even close to meeting our Paris Climate Agreement targets.

Reducing poverty and inequality and redistributing income are also key to increasing productivity and economic growth according to a recent IMF report.[i]

The new and improved Canada Child Benefit announced in the 2016 Federal Budget with an additional $4.5 billion promised to reduce the number of children living poverty by 300,000 by 2017. But that would still leave a million children living in poverty. Additional annual increases of **$1 billion** to the CCB over the next five years would be needed to eliminate child poverty. A much more ambitious poverty reduction strategy targeting seniors and working age adults would need **$5 billion** a year in additional funding for increasing the GIS top-up benefit, the GST/HST Credit and the Working Income Tax Benefit.[ii] This would pay big dividends down the road in lower health care costs as well as ensuring a larger and more productive work force.

Here are some ways the government could raise over **$23 billion in additional revenue**, without raising taxes on 80% of Canadians.

Close Tax Loopholes

Closing unfair and ineffective tax loopholes (or tax expenditures) could raise **$18 billion** in additional revenue without raising taxes. And it has the added benefit of making the tax system simpler and fairer. Here are some of the most obvious candidates for elimination or restriction:

a. **Eliminate the stock option deduction**: Over 90% of the benefit of this 50% discount on taxes goes to the top 1% of tax filers who make more than $250,000 annually. While we recommend eliminating it, the fiscal damage could still be limited by restricting this tax deduction only to high-tech start-ups. Annual savings are estimated to be about **$755 million.**[iii]

b. **End abuse of private corporations***:* The Finance Minister recently launched public consultations on proposals to tackle the tax abuse of private corporations by wealthy professionals. The government needs to implement their proposed changes despite predictable push back from vested interests. Closing this loophole would save up to **$500 million** a year.

c. **Tax income from capital gains and investments at same rate as employment income***:* Individuals and corporations who profit from the sale of investments or assets pay tax at half the rate of tax on income from employment. We recommend maintaining the lifetime capital gains exemptions, but income from capital investments should be taxed at the same rate as employment income after adjusting for inflation. Allowing for an inflation adjustment would still provide some tax deferral benefit to investors but encourage longer term investments rather than short term speculative investments. Annual savings would be **$12.5 billion.**[iv]

d. **Lifetime limit for Tax Free Savings Accounts**: The cost of foregone revenues from this tax expenditure has grown from $250 million in 2012 to over a billion dollars in 2017. It will continue to escalate to many billions annually unless a lifetime limit is set. We suggest that a $52,000 lifetime cap be put on TFSAs to avoid a revenue sinkhole in the future. Annual savings would be modest **at $120 million** initially, but would increase to billions of dollars in future years.

e. **Reduce RRSP contribution limits***:* High RRSP contribution limits provide government support to high income people who don't need help with their retirement savings while leaving less revenue available to support lower income seniors who need help the most. Lowering the annual contribution limit from the current $26,000 to $20,000 could save **$2 billion** a year while still providing a retirement savings option for most middle and lower income Canadians.

f. **Review and replace ineffective boutique tax credits**: Under the previous government, Canada's tax system became riddled with "boutique tax credits" for specific activities. These made filling out annual tax forms much more complex, and have generally not been effective in their intended objective. Recent federal budgets have eliminated several of these credits. But there are still more that should be cancelled. Annual savings of up to **$200 million** could be realized by doing this.

g. **Cancel the corporate meals and entertainment expense deduction**: Businesses can deduct half their meal and entertainment expenses, including the cost of season's tickets and private boxes at sports events. This is widely abused, according to the U.S. study of a similar measure there.[v] The meal expense for long-distance truckers could be maintained. Annual savings of **$600 million** could be expected.

h. **End fossil fuel subsidies:** The 2017 Federal Budget committed to phase out fossil fuel subsidies and while some fossil fuel subsidies have been reduced, federal tax subsidies to the fossil fuel industries still amount **to $2.9 billion** annually according to a recent report from Oil Change International.[vi] Canada signed on to a G20 commitment to eliminate fossil fuel subsidies and it much more needs to be done to deliver on this promise.

2. Stop Corporate Offshore Tax Dodging

The government has taken some welcome steps to combat tax haven facilitated tax evasion by wealthy individuals in the past two federal budgets. But we estimate that individual use of tax haven tax evasion schemes is only about one third of the tax haven problem. Two thirds of revenue losses related to tax haven abuse is likely due to corporate tax dodging.

Many large and some medium sized companies have offshore subsidiaries. A study we commissioned found that 56 of the 60 major companies listed on the TSX had a total of 973 subsidiaries in tax havens.

There is evidence both in Canada and in other jurisdictions that the primary function of tax haven subsidiaries is to shift profits to reduce corporate tax payments.

While some of the solutions will require international agreement, there are several measures the Canadian government could take now to reform corporate tax rules and stem the revenue losses due to corporate profit shifting to tax havens:

a. **Economic substance -** One way to restrict corporate tax haven abuse would be to require economic substance for any offshore subsidiary to be recognized as a separate corporate entity for tax purposes. Bill C-362, introduced in June this year by Murray Rankin, provides a good legislative example of how this could be done.[vii]
We estimate this measure **could raise at least $400 million a year**.

b. **Capping interest payments to offshore subsidiaries -** Canada used to have a cap on tax deductibility of interest payments to offshore subsidiaries but this was removed by the previous government. It is time to re-instate this measure to curb offshore abuse. The OECD has recommended doing this in their Base Erosion and Profit Shifting (BEPS) Action Plan. The British government introduced this measure in their 2016 budget, though their fixed cap at 30% is far too high to be very effective. We recommend a Group Ratio Rule, limiting the deductibility of interest to the entity's share of the group's consolidated net interest expense, apportioned by earnings (EBITDA). If this is combined with a fixed cap, it should be set at the lowest level of 10%.[viii] We estimate this measure could raise at least **$200 million** annually.

c. **Applying a 1% withholding tax on Canadian assets held in tax havens -** Canadian direct foreign investment in tax havens was estimated by Statistics Canada to be $261 billion in 2016. This amounts to a quarter of all Canadian direct foreign investment abroad. The main reason for channeling investments through tax havens is to evade or avoid paying taxes in Canada. Applying a 1% withholding tax on Canadian assets held in tax havens would likely raise revenue of over **$2 billion** a year.

3. Tax foreign-based E-commerce Companies to Level the Playing Field

E-commerce companies such as Netflix, Google (YouTube), Amazon, Facebook, Uber, and Airbnb, are capturing a huge and growing share of the Canadian market but pay little or no taxes. They have been exempted from paying taxes by the Canada Revenue Agency because they have no physical presence in Canada and therefore are deemed not to be "carrying on business" in Canada.[ix] This policy is outdated.

The foreign-based e-commerce sector now has revenues of more than $20 billion a year from sales in Canada and just Google and Facebook together capture 64% of all internet advertising dollars spent in Canada – over $2.4 billion. Internet advertising is growing rapidly and now captures 34% of all ad spending, compared with 30% for television, 13% for daily newspapers and 14% for radio.[x]

Foreign e-commerce companies are squeezing out many Canadian media companies, taxi services. hotels and retailers, including many small businesses. Good jobs are being lost. Canadian companies are losing because of unfair competition to foreign companies that pay little or no taxes.

The European Union, New Zealand, Australia, Norway, South Korea, Japan, Switzerland, and South Africa, have modernized tax laws to respond to changing e-commerce reality.[xi] The OECD in its BEPS Action Plan on Addressing the Tax Challenges of the Digital Economy has recommended ways that governments can collect value added taxes where the product is purchased to help level the playing field between foreign and domestic suppliers.[xii]

While the 2017 Federal Budget did include a requirement that ride-share businesses pay the GST, other foreign digital economy players have not been forced to play on a level playing field. Failure to update our tax policy creates unfair competition, causes significant job losses in the journalism, media and cultural sectors, threatens the vitality of Canadian culture and squanders to opportunity to raise several hundred million dollars in revenue for both federal and provincial governments.

We recommend that the Canadian government level the playing filed by:

a. Making all e-commerce companies with Canadian income above a certain threshold pay corporate income tax on profits from products or services sold or rented in Canada. It is difficult to estimate how much revenue this would raise as large foreign companies like Google and Netflix do not separate out their Canadian earnings but it could be as high as **$600 million** a year.

b. Ending the GST/HST tax exemption for electronic commerce services (above a determined sales threshold) that sell to Canadians and requiring them to collect and remit GST/HST and PST amounts to federal and provincial governments on their sales in Canada. We estimate this could raise over **$ 2 billion** a year. (2/3 of this would go to provincial governments with $600 million for the federal government.)

[i] Ostry, Jonathan D., Andrew Berg, Charalambos G. Tsangarides. 2014. "Redistribution, Inequality and Growth." International Monetary Fund (IMF) Staff Discussion Note. https://www.imf.org/en/Publications/Staff-Discussion-Notes/Issues/2016/12/31/Redistribution-Inequality-and-Growth-41291

[ii] For more details see: http://www.taxfairness.ca/en/blog/tax-system-can-reduce-poverty-and-inequality

[iii] Many of the revenue estimates are taken from Finance Canada, **Report on Federal Tax Expenditures - Concepts, Estimates and Evaluations 2017**. https://www.fin.gc.ca/taxexp-depfisc/2017/taxexp17-eng.asp

[iv] David Macdonald, **Preferential Treatment**, Canadian Centre for Policy Alternatives, May 2017, https://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2017/05/Preferential_Treatment.pdf

[v] Richard Schmalbeck and Jay A. Soled, Elimination of the Deduction for Business Entertainment Expenses http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=2733&context=faculty_scholarship

[vi] Oil Change International, **Talk is Cheap**, July 2017 http://priceofoil.org/content/uploads/2017/07/talk_is_cheap_G20_report_July2017.pdf

[vii] http://www.parl.ca/DocumentViewer/en/42-1/bill/C-362/first-reading

[viii] For details on this issue see G20 SUBMISSION ON BEHALF OF THE BEPS MONITORING GROUP to UK Parliament, All-Party Parliamentary Group Examination of the OECD'S BEPS recommendations to the G20 https://bepsmonitoringgroup.files.wordpress.com/2016/01/bmg-submission-to-uk-all-party-parliamentary-group.pdf

[ix] Canada Revenue Agency, Carrying on business in Canada, GST/HST Policy Statement P- 051R2, Date of Revision April 29, 2005. This policy statement cancels P-051R1, dated March 8, 1999: http://www.cra-arc.gc.ca/E/pub/gl/p-051r2/p-051r2-e.html

[x] John Anderson, Over the Top Exemption, 2016: Canadian Centre for Policy Alternatives, p.11. https://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2016/06/Over_the_Top_Exemption.pdf

[xi] John Anderson, Over the Top Exemption, 2016: Canadian Centre for Policy Alternatives, p.18 – 21. https://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2016/06/Over_the_Top_Exemption.pdf

[xii] http://www.oecd.org/tax/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report-9789264241046-en.htm