

October 15, 2010

Mr. John Les, M.L.A.
Chair, Select Standing Committee on Finance
and Government Services
Room 224, Parliament Buildings
Victoria, British Columbia
V8V 1X4

Dear Mr. Les:

Re: Pre-Budget Consultations – 2010

The Canadian Bankers Association is pleased to provide its submission to the Select Standing Committee on Finance and Government Services as part of the Committee's Budget 2011 consultations.

If you have any questions, or if the CBA can be of any assistance, please do not hesitate to contact me. In addition, the CBA's Director of Government Relations, Martin Lavoie, is available to you and the other members of the Committee. Martin can be reached at 613-234-4431 ext. 223, or by e-mail at mlavoie@cba.ca.

We appreciate the opportunity to participate in the Committee's pre-budget consultations.

Sincerely,



Attachment: Submission to the Select Standing Committee on Finance and Government Services

Submission to the Select Standing Committee on Finance and Government Services

Prepared by the Canadian Bankers Association

October 2010

Introduction

The Canadian Bankers Association (CBA) welcomes this opportunity to provide its input to the Select Standing Committee on Finance and Government Services, as the Committee prepares its recommendations for the 2011 British Columbia Budget.

We congratulate the government on its prudent fiscal management in closing the 2009-10 fiscal year with a deficit almost \$1 billion lower than forecasted one year ago and in continuing to improve the province's fiscal outlook as the current year progresses. The September Economic Forecast and Fiscal Plan Update (the September Update) indicates that British Columbia is in the enviable position of forecasting a better than expected financial position for the current year and the following two years. The government has decided to make a significant portion of this \$1.8 billion aggregate improvement available for allocation to revenue or spending initiatives and is requesting input on what priorities it should address with those funds.

While the September Update was positive, it also highlighted continuing risks in the economic outlook suggesting that continued caution is advisable. In the midst of these uncertainties, Canada's healthy banking sector continues to contribute substantially to the BC and Canadian economies. The banking industry accounted for 3.3% of the provincial GDP in 2009 and provided 29,000 high-paying high-skilled jobs in the province. The industry participated in the province's return to economic growth, increasing total taxes paid to the provincial and municipal governments by \$147 million to \$252 million in 2009. Banks continue to play a crucial role in the provincial economy by making financing available for new investments and job creation by BC businesses, providing \$70.1 billion in total authorized credit of which \$11.7 billion was lent to small and medium-sized businesses.

We are providing our comments on a number of important public policy issues that affect British Columbia residents and businesses and which impact the Canadian economy as a whole: a competitive tax regime, new retirement savings initiatives, a single securities regulator and financial literacy.

A Competitive Tax Regime

The government's September Update notes that the improvement in the province's fiscal plan is primarily due to higher than expected corporate income tax revenues. We commend the government on its decisions in recent years to eliminate capital taxes and to reduce corporate and personal income tax rates in order to become one of the most attractive jurisdictions in Canada (and internationally) in which to work, invest and set up businesses. The cuts in capital and income tax rates and the replacement of the inefficient provincial sales tax with a harmonized value added tax, once completed, will have reduced the marginal effective tax rate (METR) on capital investments by large and medium sized businesses from 29.5% in 2009 to 17.9% by 2018. For small businesses the METR on capital investments will decline from 24.7% in 2009 to 9.9% by 2012. These tax changes are projected to accelerate economic growth in BC, producing an additional \$14.4 billion in capital investment and 141,000 new jobs by 2020¹.

¹ Jack Mintz, "British Columbia's Harmonized Sales Tax: A Giant Leap in the Province's Competitiveness", University of Calgary School of Public Policy, SPP Briefing Papers, Volume 3, Issue 4, March 2010, p. 1.

With this foundation in place, we would like to focus on another area that affects competitiveness – efficient tax administration. Economically challenging times focus everyone’s attention on the need to be streamlined and efficient. In business, that means looking for operational streamlining that could reduce costs without affecting the quality of products or services. Government can assist business in this effort by implementing measures that improve the efficiency of the corporate tax regime.

Taxation of Corporate Groups

Corporations, including financial institutions, carry on business through a variety of organizational structures. Frequently these structures involve the use of separate legal entities which are nonetheless economically integrated into the corporate group². However, in Canada, corporations are required to report and pay tax on their income on an unconsolidated or legal entity basis. Absent consolidated tax reporting, losses incurred by some affiliates within a corporate group cannot be offset against profits earned by other affiliates. As a consequence, liquidity and international competitiveness of Canadian corporations are negatively impacted.

Some form of tax consolidation for groups of related companies is common practice in other developed countries. A recent study on the issue of consolidated reporting by the CD Howe Institute³ found that France, Germany, the United States, Australia, Italy and Japan, among others, all offer some form of consolidated reporting, and many others offer some sort of offsetting measure of similar effect. The report went on to state that Canada is the only country within the G7 which does not have consolidated reporting or a similar mechanism. The report concludes that *“Providing a comprehensive group taxation regime would bring fairness, simplicity and certainty of tax outcome for Canadian corporations. As it is, Canada’s approach to corporate group taxation gives rise to a number of problems, including higher administrative and transaction costs, unfairness among different types of corporations, uncertainty, and weakened international competitiveness.”* The 1997 Report of the Technical Committee on Business Taxation to the federal Minister of Finance and the 1985 federal Department of Finance Discussion Paper, “A Corporate Loss Transfer System in Canada”, also identified legal, accounting, administrative and compliance cost issues that would be resolved through a group reporting / loss transfer system.

While the advantages of consolidated tax reporting have been identified for decades, the impact on tax revenues of individual jurisdictions in a federal state have not been as easily resolved. For example, provincial tax revenues from a profitable BC corporation could be reduced or eliminated by an offsetting claim for the losses of an affiliate operating in another province (to the detriment of BC), or the reverse could happen (to the benefit of BC). In most cases consolidated tax reporting would not have a material impact on aggregate government revenues over time as it primarily affects the timing of the utilization of losses to offset taxable income. However this difference in timing increases uncertainty regarding the tax revenues available to a province in any single budget period as revenues may be impacted by economic circumstances in other jurisdictions. In short, while the benefits of consolidated tax reporting are well-documented, the uncertainties associated with its impact on the timing and distribution of tax revenues have made governments reluctant to proceed absent further study.

² In fact, the Bank Act and governing legislation for other types of financial institutions require them to set up separate legal entities for certain lines of business.

³ Alexandre Laurin, “Cleaning Up the Books: A Proposal for Revamping Corporate Group Taxation in Canada” C.D. Howe Institute Commentary No. 284, March 2009.

The 2010 federal Budget included a commitment to explore whether new rules for the taxation of corporate groups – such as the introduction of a formal system of loss transfers or consolidated reporting – could improve the functioning of the tax system. Subsequently, in its 2010 Budget, the Ontario government offered to work collaboratively with the federal government to explore options to address the impact on interprovincial income allocation of transactions to utilize losses within corporate groups. The CBA welcomes these announcements and urges the British Columbia government to participate in this review.

Recommendation: Participate in a review of the taxation of corporate groups to develop a consolidated tax reporting regime that would improve the functioning of the tax system and the competitiveness of Canadian corporations.

Interprovincial allocation of corporate income taxes

Corporate income taxes paid by banks and other financial institutions are allocated to individual provinces based on special formulae. The formula for banks was developed decades ago and uses salaries and wages and deposits and loans as proxies to determine taxable income earned in a jurisdiction. Trust and loan companies, which are often part of the banking group, use a very different basis for allocation, which adds administrative and compliance complexity. Changes in the manner in which financial products and services are produced and delivered and increasing complexity in financial instruments have raised concerns that these formulae no longer produce an equitable result. There are frequent provincial challenges to the results of the allocation formula in which individual provinces may unilaterally reassess an institution to increase their share of the total pie. Resulting appeals can take as long as 10 to 15 years to resolve. These disputes create uncertainty for all provincial governments with respect to their tax revenues for a particular year since all must ultimately agree to a revised allocation. They also create uncertainty for the financial institutions involved with respect to their tax liabilities since they may end up paying tax twice on the same dollar of income and are charged interest on “late payments” when the allocation between provinces is changed. Both sides also incur greater administrative costs.

Recommendation: Explore measures to improve the equity of the interprovincial allocation formula as it applies to banks and trust and loan companies and to improve the efficiency and timeliness of the audit process, in collaboration with the federal government and the governments of the other provinces and territories.

New Retirement Savings Initiatives

Over the past year, governments and interested stakeholders have examined the extent to which Canada’s retirement system meets the needs of Canadian families. Much discussion and research has considered the extent to which the system meets the needs of current retirees, those near retirement and those who are still early in their working lives. This examination has also considered the challenges facing those who are part of employer pension plans, but whose benefits may be at risk, and those who have no employer pension plan.

It has been recognized that a key focus going forward should be on those middle-income Canadians who do not appear to be saving adequately for retirement because they have no access to employer pension plans, or because those plans are inadequate. These Canadians have the option of saving individually in a variety of ways, whether tax assisted or not. While these individual savings offer a great deal of flexibility to savers,

these Canadians miss out on the advantages associated with large, professionally managed pension plans. The CBA believes they should have the option to participate in such plans even if their employers choose not to sponsor pension plans.

Consequently, the CBA applauds the announcement by the federal Minister of Finance following the June 2010 meeting of finance ministers in Charlottetown that governments would be considering innovations that would permit financial institutions to offer broadly based defined contribution pension plans to all working Canadians. We believe that all Canadians, including small business owners and the self-employed, should be given access to structured pension plans by delinking pension plans from the employment relationship and allowing third parties (such as banks and other financial institutions) to provide such plans. Canada's financial sector is well placed to deliver such products in a convenient and efficient manner and we believe that these plans could be as efficient as any delivered by quasi-public supplemental pension plans. In designing these new innovative products, governments should be cognizant of the fact that different financial institutions operate under differing legislative regimes. We believe the goal should be to design products that are of best value to Canadians and to allow the broadest range of financial institutions to offer these products on a level playing field basis. Our analysis and recommendations were included in a report entitled "Enhancing Canadians' Savings Options: Strengthening the Third Pillar in Canada" issued in April⁴.

The development of new types of pension plans as outlined above is largely designed to meet the pension needs of younger workers. We also believe that other changes to the retirement system would be of benefit to Canadians, including those closer to retirement. For example, the personal income tax system contains many measures related to retirement savings including tax incentives to save, preferential tax treatment of retirement income and measures to ensure that savings in deferred tax plans are ultimately withdrawn and subjected to taxation. Reforms to these measures could have a dramatic positive impact for those who are near retirement and these measures could provide more flexibility in decisions on when and how to save for retirement, and on when and how much to withdraw to fund living expenses in retirement. We also believe that a review of personal income tax measures would be beneficial to address greater life expectancy and to remove disincentives to continue working beyond age 65. The CBA recognizes that such a review needs to be undertaken by the federal government but provinces could play an important role in championing such reforms.

Such a review should consider:

- a delay in the age at which contributions can no longer be made to RRSPs and funds must be withdrawn;
- adjustments to the minimum annual withdrawal amounts for RRIFs / LIFs, in view of lower investment returns and extended life spans which impact the sustainability of retirement income;
- lifetime, rather than annual, contribution limits for deferred tax plans and TFSAs to reflect the fact that financial and personal circumstances change throughout the working years;
- equity in the amount of tax deferral room provided in, and tax treatment of, retirement income from, various types of deferred tax plans; and
- a reduction in the tax rate applied to retirement income from deferred tax plans.

⁴ The report is available at http://www.cba.ca/contents/files/submissions/sub_20100426_pension_en.pdf.

Recommendation: Champion a national review of personal income tax measures related to retirement savings in order to provide residents of British Columbia (and all Canadians) with greater flexibility in decisions related to saving for retirement and utilizing retirement savings once retired, and to provide them with equitable access to preferential tax measures.

Single Securities Regulator

For many years, the CBA has advocated for efficient securities regulation, with the strong belief that a national securities regulator will benefit all Canadians. We are pleased to see that significant progress is being made with the publication of a transition plan and the federal government's decision to refer the draft Canadian Securities Act to the Supreme Court of Canada.

We are also pleased with the decision by the vast majority of provinces and territories to participate with the federal government in the development of a transitional plan. We hope that in 2011 those jurisdictions, as well as the currently non-participating jurisdictions, will be prepared to sign memoranda of understanding with the federal government to create a Canadian Securities Regulatory Authority.

The CSRA will take on a mandate new to Canadian securities regulators, namely to "contribute to the integrity and stability of the financial system, as part of the Canadian financial regulatory framework." The events of the recent global financial market turmoil demonstrate that capital markets, their products and their institutions, are closely linked to the financial markets more broadly. Risk moved quickly from unregulated financial institutions to capital markets to regulated financial institutions and to the economy more generally. The CSRA will enable Canadian financial regulators to deal with such integrated risk in the future and contribute to the soundness and macro prudential stability of the financial sector more generally.

Moreover, it is important to recognize that many of the decisions that will affect Canada's financial system very broadly will be made within a global context. Within this context it is vitally important that Canada has regulatory bodies that can speak for Canada and that have the international credibility to be influential.

Finally, the CBA recognizes the importance of ensuring that the provinces and territories have meaningful input into the creation of the CSRA. In this regard, we believe that the choice of Mr. Douglas M. Hyndman, the former head of the British Columbia Securities Commission, to chair the Canadian Securities Transition Office is an important step. The fact that British Columbia and nine other provinces and territories are participating in the transition efforts to move from a fragmented to a single regulatory structure is a concrete indication that Canadian federalism works.

Financial Literacy

We applaud the government of British Columbia for its recognition of financial literacy as an important life skill and for its leadership in including financial literacy in the high school curriculum. The banking industry shares the government's commitment to improving financial literacy and for years, the banks, as well as the CBA, have been providing their customers and the general public with information to help them better understand the financial products and services that they use and the economic functioning of the country as a whole.

As an example, the CBA brings financial literacy to Canadians through its high school seminar program, YourMoney, which has taught more than 192,000 senior high school students about budgeting, borrowing, saving, investing, and protecting themselves from fraud. Established in 1999, the non-commercial seminar uses volunteer bankers from the local community to teach young Canadians about responsible money management. YourMoney is offered in collaboration with the Financial Consumer Agency of Canada (FCAC).

In June of 2009, the federal government established its Task Force on Financial Literacy to make recommendations to the Minister of Finance, by the end of 2010, on a national strategy to strengthen Canadians' financial literacy. The CBA strongly supports the mandate and the work of the Task Force. We provided it with a submission of recommendations⁵ and appeared before the Committee in May as part of its consultations. Included in the CBA's recommendations are the need to make financial education a part of the high school curriculum across Canada, and that the national financial literacy strategy should tap into the broad expertise and experience of the private sector, including banks and other financial services providers.

Conclusion

We commend the government on the province's strong financial position. Difficult decisions have been made and British Columbia appears to be well underway on the path to renewed economic growth and ultimately a return to balanced budgets. We recommend that this budget focus on measures to enhance the climate for business investment and job creation in the province and in Canada as a whole. This is an opportune time to work with other Canadian jurisdictions to move forward with the establishment of a single securities regulator and to improve the efficiency of the tax system for corporations. We also recommend that the government move forward in collaboration with other jurisdictions to implement new retirement savings initiatives and to review personal income tax measures relating to the retirement income system.

⁵ The submission is available at www.cba.ca/contents/files/submissions/sub_20100429_taskforcefinlit_en.pdf.