

January 12, 2009

The Honourable James M. Flaherty, P.C. M.P.
Minister of Finance
House of Commons
Parliament Buildings
Ottawa, Ontario
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Dear Minister,

On behalf of PricewaterhouseCoopers LLP and its associate law firm Wilson & Partners LLP, I am pleased to submit tax proposals for you to consider as you prepare the Government's next budget to be tabled in Parliament on January 27, 2009.

The recent actions taken by the Government during the current economic crisis have been directed at improving the liquidity of Canadians, stimulating recovery and creating sustainable growth in Canada. These actions include:

1. A temporary program for guaranteeing inter-bank loans to enhance liquidity.
2. A \$25 billion dollar program for buying mortgages from banks to provide liquidity and encourage lending.
3. Additional funding to the Export Development Corporation to encourage export sales and an increase in the capital of the Federal Business Development Bank to permit it to lend money to Canadian business for use in sustainable ventures.
4. Increase infrastructure investment.
5. A financial support package for the Canadian auto industry.

These and other measures the Government has taken are extremely important and greatly appreciated. While not exhaustive, the tax proposals we are submitting are additional measures that we believe the Government could take to further address the liquidity needs of Canadians, stimulate the economy and promote sustainable growth. We believe that our tax proposals are

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consistent with the Government's long term economic policy as articulated in *Advantage Canada*, released in the fall of 2006. We encourage the Government to seriously consider them.

Tax Proposals to Further Improve Liquidity, Stimulate Recovery and Create Sustainable Growth in Canada

The tax proposals below should be considered in conjunction with a broader fiscal stimulus plan with the objective of improving liquidity and creating sustainable growth in the Canadian economy. As indicated below, a certain number of these proposals are being considered or have been adopted by other countries.

Proposals affecting corporations¹

- **Maintain and accelerate the current policy of reducing corporate income tax rates** – We believe that lower corporate tax rates are a critical part of any plan to make Canada an attractive place for both domestic and international business investors. The lowering corporate tax rates will also be a source of working capital that can be used by corporations to fund their current operations and growth.
- **Facilitate the use of tax losses and credits of the members of a corporate group by other members of that corporate group** - Permit members of a qualifying corporate group to utilize tax losses and investment tax credits of other members of the group to shelter income and reduce taxes. A qualifying corporate group would include a taxpayer (the holding taxpayer) and each other corporation in which the holding taxpayer has a minimum, direct or indirect, equity interest measured by reference to votes and value attributable to shares. This proposal would increase the liquidity of such groups as well as introduce greater efficiency and fairness into the tax system. Members of such groups would no longer be required to undertake complex and time consuming transactions to achieve such consolidation. The current techniques employed by such groups to realize the tax benefits have been generally blessed by the taxation authorities but are expensive to employ and are inefficient. The international competitiveness of Canadian business suffers as most other countries accommodate tax consolidation.²

¹ Certain of these proposals are applicable or can be modified to apply to individuals.

² The Advisory Panel on Canada's System of International Taxation suggested that the Government consider how a tax consolidation system could operate in Canada, which is prevalent in a number of other countries, including many of Canada's largest trading partners.

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- **Modify the loss carry over rules to extend tax loss carry backs from 3 to 5 years** – Taxpayers with losses such as business losses for a particular taxation year may currently deduct those losses in the last 3 taxation years preceding the particular year. Extending the carry back period from 3 years to 5 years will enhance liquidity of businesses that were profitable in prior years but are or will be realizing business losses during the current economic downturn.³
- **Change the carry back and carry forward rules for donations to parallel the carry back and carry forward rules for business losses** – In the current economic environment and under the current rules, taxpayers that have made charitable donations may not have the level of income needed to realize the tax benefit that they otherwise expected to receive. This will have a negative effect on charitable giving in the future. The carry over period provided for business losses could be extended to charitable donations.
- **Temporarily permit a corporation to monetize its tax losses by selling those losses to the government** - Permit a corporation resident in Canada that is in financial difficulty and that incurs losses from carrying on active business in Canada to sell those losses to the Government and encourage the provincial governments to enact a similar proposal. This would be a temporary measure applicable to losses arising, for example, after 2008 and before 2012. The compensation could be 15 cents for each dollar of loss – 10 cents (federally) and 5 cents (provincially).
- **Temporarily permit capital losses to offset the ordinary income of taxpayers** - Under current rules, generally, an allowable capital loss of a taxpayer can only be deducted from a taxable capital gain of the taxpayer. Allowing a taxpayer to deduct an allowable capital loss from the other income of the taxpayer would monetize such losses sooner to give taxpayers increased liquidity.⁴ This would be a temporary measure and apply to allowable capital losses of a taxpayer arising, for example, after 2008 and before 2012.
- **Temporarily enhance the ability of taxpayers to earn investment tax credits for new investments** – An enhanced investment tax credit for new qualified investment would lower the cost of such investment and encourage current spending.⁵ This would be a temporary measure and apply to qualifying expenditures of a taxpayer arising, for example, after 2008 and before 2012.

³ This proposal parallels a current US income tax proposal.

⁴ Ibid.

⁵ Ibid.

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- **Temporarily extend and expand the ability to monetize existing tax credits such as the R&D tax credits** – Allowing for the immediate monetization of tax credits will enhance the liquidity of businesses with current losses or that are otherwise unable to claim these credits. Companies in a loss position typically need access to capital and allowing for utilization of their already existing credits will help increase their liquidity, lower the current cost of such investment and assist in funding new investments.⁶
- **Temporarily suspend the “acquisition of control” rules** – These rules may result in the expiry of tax losses when a company is acquired. Suspending these rules for either a certain period of time or for certain industries would facilitate the takeover/consolidation of companies under financial distress and in need of an injection of new capital or financing.⁷
- **Introduce flow through shares for R&D** – Permit a corporation to renounce its approved R& D expenditures and credits to investors that invest in flow through shares. The expenses so renounced would be deductible by the investor and reduce the cost to the investor of their shares in the company. The expenditures would not be deductible by the corporation. This measure could also be extended to permit companies in certain industries to renounce, for example, capital cost allowance claims to new shareholders.
- **Participating debt** – Treat participation payments paid by a corporation on arm’s length debt as interest for Canadian tax purposes to permit risk and reward sharing on a project by project basis and to enhance liquidity.
- **After tax financing** – Permit a corporation in financial difficulty and carrying on an active business to renounce to an arm’s length lender all or a portion of its interest deduction in respect of a loan made after 2008 and before 2012 to the corporation by that lender. This measure would reduce the cost of borrowing and promote liquidity.
- **Capital gains reserve** – Provide a 5 year reserve for any income or capital gains realized by a corporation after 2008 and before 2012, on the disposition of assets used in an active business or of shares of an active business corporation where all or substantially all of the proceeds of disposition are used to acquire active business assets or retire debt incurred to acquire active business assets used in a business carried on in Canada. In addition, permit reserves under paragraph 20(1)(n) to match the period over which cash is received for sale of properties.

⁶ Ibid.

⁷ Ibid.

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- **Temporarily reduce the required estimated tax payments of corporations to, say, 90% of current liability** – A temporary reduction in estimated tax payments can provide companies with additional short-term liquidity without creating any revenue loss to the federal government.⁸ On a similar note, reduce/eliminate the amount required by taxpayers to pay to the Canada Revenue Agency with respect to a reassessment until such reassessment is sustained on appeal by the taxpayer.
- **Announce support for recommendations of the Advisory Panel on Canada's System of International Taxation** – The Panel's recommendations are consistent with the government's economic policy as articulated in *Advantage Canada* and are intended to improve the competitiveness of Canadian businesses and to make the tax system more efficient. In particular:
 - Repeal the rule limiting the deduction of interest (i.e., section 18.2). This would send a very positive message of support to Canadian businesses and give them more flexibility in financing their investments in Canada and abroad.
 - Accept the recommendation that all foreign active business income earned by foreign affiliates of Canadian companies (as well as capital gains arising on the disposition of shares of foreign affiliates carrying on an active business) should be exempt from Canadian taxation. This would be consistent with international norms and would facilitate the investment of funds and repatriation of income to Canadian shareholders.
 - Expand the "safe harbour" provision in the Act to increase the extent to which Canadians can provide services to non-residents without causing the non-residents to be considered to be carrying on business in Canada. An expansion of the current rule would provide the opportunity to retain and attract people and jobs to Canada in areas such as financial services and technology.
- **Stimulus for the construction industry**
 - **Temporary goods and services tax relief on new housing** – There is currently a GST rebate for newly constructed housing, which effectively lowers the rate from 5% to 3.2% for new houses up to \$350,000 (the relief is phased out between \$350,000 and \$450,000). Temporarily increase the rebate and extend it to higher value houses (e.g., full rebate to \$400,000 with a phase out to \$800,000) to stimulate construction activity and increase employment in the home building industry, as well as forestry and related sectors. In addition, provide GST relief

⁸ Ibid.

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for certain other construction activities by permitting entities such as universities, hospitals and school boards to claim full GST relief for construction projects.

- **Temporary repeal subsections 18(2) and (3)** – These provisions currently require the capitalizing of certain soft costs (i.e., interest and property taxes) to be capitalized during the land ownership and construction phases. Permitting a current deduction for such expenditures would reduce the current cost of such expenditures.
- **Permit component tax depreciation for new construction projects** – Under current rules, the cost of new buildings is depreciated at a rate of 6% and includes costs of various components such as elevators, heating and energy systems. To assist taxpayers to recover their costs more quickly and to spur construction activity, the costs of such components could be depreciated at a higher rate.
- **Tax free municipal bonds to help finance infrastructure projects** – The Government has already set aside \$33 billion for infrastructure spending. This measure would increase the availability of funds for such projects by permitting Canadians to make secure investments to help fund such expenditures. Such a measure could also apply to bonds issued by corporations that are guaranteed by the federal or a provincial or municipal government.

Proposals affecting individuals

- **Permit individuals to increase contributions to their tax free savings account** – This could be achieved by allowing a one-time special contribution of, say, \$25,000-\$50,000 by an individual a TFSA. This would further encourage the growth in low cost funds that could be available to Canadian business.
- **Capital gains exemption for new stock purchases** – This measure would help companies raise new funds.
- **Relax RRSP withdrawal rules** – In tough economic times, many families may be forced to withdraw funds from their RRSPs as an emergency measure. In such a case, the beneficiary's RRSP contribution room should be adjusted to permit subsequent contributions to make-up for the withdrawals. This measure would put RRSPs on the same footing as tax-free savings accounts.

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Proposals affecting GST and sales tax

- **Temporary modification to GST rate** – As an incentive for consumer spending, a two stage measure could be considered - first reducing GST rate to 4% for the remainder of 2009, followed by a rate increase to 6% effective, say, July 1, 2010. This two stage measure would provide an additional incentive for taxpayers to spend more in 2009 (i.e., to spend rather than save income tax cuts) and to provide a means to begin to recover the cost of the incentive when the economy rebounds.
- **Sales Tax Harmonization** – We endorse the Government's desire to move to a fully harmonized system of sales taxes now modeled by the Atlantic Provinces and we support any new initiative to persuade the non-harmonized provinces to embrace this initiative. Harmonization would be particularly beneficial for the manufacturing sector because it would remove the provincial sales tax drag on exports that still exists in the non-harmonized provinces.

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We appreciate having the opportunity to submit our recommendations. We would welcome any opportunity to discuss them in greater detail with you or your staff.

Yours truly,



Nick Pantaleo, FCA
Leader,
Canadian National Technical Services

cc Rob Wright, Deputy Minister, Department of Finance
Stephen R. Richardson, Associate Deputy Minister, Department of Finance