

# Leveraging our public resources

A submission to the House of Commons Standing Committee on Finance

Association of Canadian Financial Officers  
August 3, 2017



## Introduction

In its call for submissions to this round of pre-budget consultations, the Standing Committee on Finance expressed interest in federal measures to increase Canada's productivity and competitiveness.

The Association of Canadian Financial Officers represents the accounting and financial management professionals in the federal public service. As such, we are uniquely placed to recognize that the federal government has significant resources at its fingertips that could be better leveraged to improve Canada's productivity and competitiveness. Specifically, we believe the government should:

- draw on the expertise and efficiency of its world-renowned public service; and
- collect and reinvest tax revenue that is rightfully owed.

A recent British study confirmed that Canada's public service is the most effective in the world.<sup>1</sup> Canadian public servants' top ranking was based on overall score for performance measures including fiscal and financial management.<sup>2</sup>

Our productive, world-class public service is a tremendous competitive advantage for Canada. The government should leverage this advantage when tackling efficiency projects such as reforming financial reporting standards and conducting departmental spending reviews.

The government should also draw on tax revenues that are rightfully owed but currently going uncollected. The Canadian government should modernize the stock option deduction and eliminate transfer mispricing, and reinvest these tax resources into initiatives designed to encourage economic growth and innovation.

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<sup>1</sup> [http://www.bsg.ox.ac.uk/sites/www.bsg.ox.ac.uk/files/documents/6.3440\\_IFG\\_InCISE\\_Report\\_Main\\_WEB.PDF](http://www.bsg.ox.ac.uk/sites/www.bsg.ox.ac.uk/files/documents/6.3440_IFG_InCISE_Report_Main_WEB.PDF)

<sup>2</sup> Ibid.

# Recommendation 1: Draw on the public service to design and conduct departmental spending reviews

## Context

The federal government's Budget 2017 included plans to review the spending of three departments or agencies. The stated purpose of these spending reviews is to "eliminate poorly targeted and inefficient programs, wasteful spending, and ineffective and obsolete government initiatives."<sup>3</sup> Recently, a representative from Treasury Board indicated the government will likely make these departmental spending reviews an annual practice.

There has been no indication yet as to whether these annual spending reviews will be designed and conducted by external, private contractors. In 2016, federal government spending on contracted services supplied by private companies was over \$8 billion.<sup>4</sup>

Recent research has demonstrated that there are significant risks associated with external contracting. Scope creep, change fees and other hidden costs can make contracting out expensive and unpredictable.<sup>5</sup>

By contrast, a comprehensive global study out of Britain has shown that Canada has the hardest-working and most effective public service in the world, with Canada scoring high on all measures including fiscal and financial management.<sup>6</sup>

## Recommendation

ACFO strongly encourages the government to draw on the resources of its world-class public service to develop a framework for departmental spending reviews and to conduct the reviews themselves. The federal government's Financial Officers would be especially well-placed to perform this important role.

## Rationale

If the goal of departmental spending reviews is to reduce inefficiency and wasteful spending, it follows that the government should not to divert resources to expensive, unpredictable contractors.

<sup>3</sup> <http://www.fin.gc.ca/access/tt-it/rfte-edff-eng.asp>

<sup>4</sup> <http://www.pipsc.ca/portal/page/portal/website/memberservices/representation/cb/pdfs/programmedtofail.en.pdf>

<sup>5</sup> Ibid.

<sup>6</sup> [http://www.bsg.ox.ac.uk/sites/www.bsg.ox.ac.uk/files/documents/6.3440\\_IFG\\_InCISE\\_Report\\_Main\\_WEB.PDF](http://www.bsg.ox.ac.uk/sites/www.bsg.ox.ac.uk/files/documents/6.3440_IFG_InCISE_Report_Main_WEB.PDF)

We need only look to Shared Services or the Phoenix pay system for a stark reminder of the risks of contracting out.

The government should instead rely on Canada's world-class public service to design and conduct spending reviews. Financial Officers have the expertise, strategic thinking and analytical skills required for these projects. Unlike external contractors, they also have invaluable institutional knowledge.

Drawing on Financial Officers to create a framework for departmental spending reviews and to conduct the reviews would also be more in keeping with the promises made by the government to Canadians and especially the public service.

The Prime Minister has repeatedly vowed to strengthen the middle class, and has cited stable, unionized public service jobs as important to middle class prosperity. Drawing on permanent, full-time public service as a resource for projects such as the departmental spending review would be a significant demonstration of the government's ongoing commitment to upholding these promises.

## Recommendation 2: Draw on the public service to strengthen financial reporting standards

### Context

In its Commentary on the 2015–16 Financial Audits, the Office of the Auditor General highlighted the importance of government financial reports both to the Canadian public and to elected officials who rely on the information provided in the reports to support their decision-making.

The Auditor General’s Office states that the information in these reports should be “relevant, clearly articulated, and presented in a way that makes its importance easy to understand. It must also be easy to navigate.”<sup>7</sup> The picture it paints of the current reporting system, however, falls short of this goal.

The current status of government financial reports is a contradiction of duplicated, unnecessary information in some cases, and a lack of centralized, useful information in others. The Auditor General’s Office identified “information overload” as one issue with financial reports, but also noted that financial information is “hard to find” and “difficult to understand,” and that some “relevant information was available elsewhere,” not in the reports themselves.<sup>8</sup>

### Recommendation

ACFO recommends that the government fund a cross-departmental review of the reporting system and requirements and that it draw on the resources of the public service – specifically Financial Officers – to do so.

The goal of this review should be financial reports and reporting requirements that are clear, consistent and useful. The reports should be accessible to the average Canadian and should provide elected officials with the information they need to support decision-making.

### Rationale

The Auditor General’s Office reports the cost of auditing the government’s financial statements as an estimated \$29 million.<sup>9</sup> This, of course, in addition to the time, resources and energy required from the public servants who prepare the reports in the first place.

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<sup>7</sup> [http://www.oag-bvg.gc.ca/internet/English/parl\\_oag\\_201705\\_00\\_e\\_42204.html](http://www.oag-bvg.gc.ca/internet/English/parl_oag_201705_00_e_42204.html)

<sup>8</sup> Ibid.

<sup>9</sup> Ibid.

A cross-departmental review of the financial reporting system would be an investment upfront but it would save the government money in the long-term by making reporting more efficient and reducing the burden of producing unnecessary or duplicate information.

This would result in cost savings for the public servants who prepare the reports, allowing their time and energy to be invested in providing the strategic insight and expert financial advice at which they excel. It would also reduce the costs associated with the Office of the Auditor General's reviews, resulting in less time spent combing through unnecessary, confusing and duplicate information. This review would also ultimately improve the quality of the information provided in the reports, which in turn would support better strategic decision-making based on more accurate information.

The Financial Officers represented by ACFO are frequently responsible for the preparation of financial reports and have identified many of the very same issues reported in the Auditor General's Office 2015-2016 commentary. As qualified, experienced public financial professionals, they have unique insight to offer into how to streamline and improve financial reporting.

## Recommendation 3: Modernize stock option deductions

### Context

The stock option deduction allows those whose compensation is partially comprised of stock options to pay taxes on only 50% of the income they receive from cashing in their company stocks.

This is not a widespread benefit: over 90% of the benefit of this loophole goes to the top 1% of income earners.<sup>10</sup> It is also very expensive, with current estimates putting the costs to federal and provincial governments combined at \$1 billion per year in lost revenue.<sup>11</sup>

The stock option deduction is also economically dangerous. Top Canadian economists have definitively stated that the stock option deduction encourages short-term thinking and risky, destabilizing behaviour.<sup>12</sup> Former Bank of Canada governor Mark Carney has identified similar destabilizing behaviour as one of the causes of unstable financial markets.<sup>13</sup>

### Recommendation

Principles of fairness would dictate that stock options earned as compensation for employment should be considered regular employment compensation and taxed accordingly. However, we recognize the concerns of Canada's startup companies reflected in the 2015 Liberal election platform "A New Plan for a Strong Middle Class." Rather than the total elimination of the stock option deduction, the Liberal platform pledged to eliminate the deduction on incomes over \$100,000.

ACFO recommends that the government uphold this promise to eliminate the stock option deduction on incomes over \$100,000.

### Rationale

Stock options are income and the government is rightfully owed tax revenue on that income. Based on estimates contained in the Liberal election platform, eliminating the stock option deduction on incomes over \$100,000 could generate \$560 million per year.

Modernizing the stock option deduction would improve the productivity of the Canadian economy by generating tax revenue that could then be invested back into the economy to create jobs and boost long-term growth.

<sup>10</sup> <http://www.taxfairness.ca/en/news/stock-options-billion-dollar-tax-loophole>

<sup>11</sup> <http://www.taxfairness.ca/sites/taxfairness.ca/files/factsheets/stock-option-factsheet-april2.pdf>

<sup>12</sup> <http://www.progressive-economics.ca/2010/03/03/stock-options-the-buyback-boondoggle-and-the-crisis-of-capitalism/>

<sup>13</sup> Ibid.

## Recommendation 4: Work to eliminate transfer mispricing

### Context

Each year in Canada, billions of dollars are lost to tax exploitation. Tax exploitation includes a broad range of tactics – some illegal and some still technically permitted via loopholes in the tax code – aimed at reducing the amount of money an individual or corporation rightfully owes the government in taxes. One of the most prevalent tactics is the use of tax havens and transfer mispricing.

Transfer mispricing occurs when corporate subsidiaries in tax havens or low-tax jurisdictions, such as Switzerland, Ireland or the Bahamas, are notionally assigned goods, intellectual property and/or services produced by Canadian parent or sister companies. The royalties and/or profits on the sale of those goods to a third party are fictionally realized in the tax haven and thus taxed at a lower rate, though the goods and services are never actually transferred.

Under these schemes, Canada is denied all or part of the tax revenue from goods and services produced in Canada. According to Statistics Canada, \$199 billion is invested in tax havens around the world.<sup>14</sup> Estimates put the amount of tax revenue lost to tax havens at between \$6 and \$7.8 billion each year.<sup>15</sup>

Over the past few years, the federal government has made strides toward combatting tax exploitation. It has invested millions of dollars into Canada Revenue Agency to identify tax evasion and avoidance and improve tax compliance. In late 2016, the government enacted legislation that requires large multinational corporations to file country-by-country reports, which will provide more information to tax agencies about corporations' earnings internationally. Budget 2017 specifically identified tax fairness as a top priority, and just recently, the government upheld one of its promises to target "income sprinkling" using private corporations.

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<sup>14</sup> <https://www.thestar.com/news/world/2016/04/04/how-offshore-tax-havens-are-costing-canada-billions-of-dollars-a-year.html>

<sup>15</sup> Ibid.



## Recommendation

These important steps are to be commended but there is significant work to be done before Canada achieves anything resembling true tax fairness. It is not enough to combat one form of domestic tax avoidance, or to improve the government's access to information about corporations' exploitative tax behaviour overseas.

Transfer mispricing and other forms of tax exploitation persist because the tax regime does not specifically prohibit the behaviour. Therefore, ACFO strongly recommends that the government commit to reforming tax laws to end transfer mispricing.

## Rationale

As discussed above, tax avoidance involving tax havens costs the federal and provincial governments approximately \$7.8 billion per year.

These profits that are unfairly sheltered overseas are the result of operating in a Canadian marketplace, using public resources. The profits would not be earned without the use of Canadian infrastructure and a Canadian workforce whose healthcare and education is now disproportionately paid for by citizens who pay their fair share of income tax. In effect, these corporations and individuals are a drain on the economy, using publicly-funded resources but refusing to contribute their share.

Allowing these funds, rightfully owed to the Canadian government, to go uncollected erodes Canadian productivity and competitiveness. The government should eliminate transfer mispricing, collect what is owed and invest these resources into public goods, services and infrastructure that support true innovation and grow the economy.

## Conclusion

As the representatives of the financial management community in the public service, ACFO is well-positioned to see how the government can leverage resources that are currently underutilized to improve Canada's competitiveness and productivity.

The federal government should draw on its world-class public service to conduct modernization initiatives and should collect tax revenues that are rightfully owed so they can be reinvested in public goods and services that support innovation and growth.