

Paying for a progressive Canada

A submission to the House of Commons Standing Committee on Finance

Association of Canadian Financial Officers
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Introduction

The newly-elected Government of Canada is facing a difficult challenge. Having been elected on a platform promising progressive change and a restoration of important social programs, the global economy is such that any significant spending initiatives will likely require large deficits.

This is commonly positioned as a zero-sum game. The treasury is what it is and one must choose where to cut if one intends to spend. However, little consideration is given to how to grow the treasury so that more spending can take place.

The Association of Canadian Financial Officers represents the FI Community in the federal public service. Our members are the accountants and financial managers who are entrusted with the vital role of stewards of the public purse. We know what good financial management looks like and we know why it is important.

We believe the following three steps can help pay for the progressive agenda Canadians want without being reckless with the resources at hand:

- Step 1: Collect what is owed
- Step 2: Find new revenue sources
- Step 3: Prevent waste and mismanagement

The recommendations that follow would go a long way towards achieving the balance needed to deliver on the government's ambitious agenda.

Step I: Collecting what is owed

In many ways, the debate over personal and business tax rates has been rendered moot by aggressive tax avoidance strategies employed at both the individual and corporate level. To put it simply: it doesn't matter what the posted tax rate is if the highest earners aren't paying it.

Average Canadians and small businesses fund public resources like healthcare and infrastructure by paying their share of taxes but high earners and large corporations, who benefit from these same resources, use an array of tactics to avoid contributing their share.

It simply isn't fair.

ACFO has two recommendations for the 2016 budget that would serve the dual purpose of generating revenue to fund a progressive social agenda and bringing much-needed fairness to the Canadian tax regime.

Recommendation 1: Eliminate stock option deductions

Context

ACFO believes that the principles of fairness require that all Canadians pay their fair share of tax on their income regardless of how that income is structured.

The stock option deduction allows those whose compensation is partially comprised of stock options (typically CEOs and executives) to pay taxes on only 50% of the income they receive from cashing in their company stocks. This sort of arrangement isn't available to the average Canadian, who pays taxes on all his/her income after the usual \$11,000 exemption.

It should be noted this is not a widespread benefit: over 90% of the benefit of this loophole goes to the top 1% of income earners.¹

While the stock option deduction doesn't provide any value to the majority of Canadians, it costs them a great deal: this deduction cost the federal and provincial governments combined an estimated \$1 billion per year in revenue.²

Not only is the stock option deduction expensive and of little value to most Canadians, it is also economically dangerous. Top economists from across Canada have definitively stated that the stock option deduction should be eliminated. They have also stated that it encourages short-term thinking

¹ <http://www.taxfairness.ca/en/news/stock-options-billion-dollar-tax-loophole>

² <http://www.taxfairness.ca/sites/taxfairness.ca/files/factsheets/stock-option-factsheet-april2.pdf>

and risky, speculative behaviour – behaviour that former Bank of Canada governor Mark Carney has identified as one of the causes of unstable financial markets.

Recommendation

ACFO has previously advocated for the elimination of all stock option deductions. After all, principles of fairness would dictate that stock options earned as compensation for employment should be considered regular employment compensation and taxed accordingly.

However, ACFO recognizes the concerns of Canada’s startup companies reflected in the 2015 Liberal election platform “A New Plan for a Strong Middle Class.” As such, as a first step, ACFO recommends the federal government implement the proposals laid out in the election platform.

Value

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.

Recommendation 2: Eliminate transfer mispricing

Context

Another significant source of public revenue that goes unrealized every year is the billions of dollars lost to tax avoidance. This is separate and distinct from a crackdown on tax evasion as outlined in the 2015 Liberal election platform. Tax evasion is illegal; tax avoidance is legal.

Tax avoidance takes many forms but the most prevalent and expensive forms typically involve the use of subsidiary or shell companies with no or few employees whose funds are centered in low-or no-tax nations such as Switzerland, Ireland or the Bahamas.

Transfer mispricing is one such form of avoidance. Essentially, corporate subsidiaries in low-tax jurisdictions 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. Canada is thereby denied all or part of the tax revenue from goods and services produced in Canada. It is a shell game that persists because the tax regime does not clearly prohibit the behaviour.

Based on numbers provided by Statistics Canada, Canadians for Tax Fairness estimated that in 2014, 10 tax haven jurisdictions alone housed over \$199 billion.³ They also estimated that federal and provincial governments combined lost approximately \$7.8 billion through tax avoidance and

³ http://www.taxfairness.ca/sites/taxfairness.ca/files/factsheets/tax_havens_fact_sheet_2015.pdf

evasion schemes involving tax havens in 2014.⁴ Even more concerning than these numbers is the rate at which they are growing. The \$199 billion quoted above is a full \$38 billion more than just two years ago in 2012.⁵

To give a sense of scale to this problem, approximately 60% of international trade happens within, rather than between, multinationals: that is, across national boundaries but within the same corporate group⁶. Suggestions have been made that this figure may be closer to 70%.

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. This is simply poor financial management.

Canada has thus far had a hand in crafting OECD recommendations aimed at tackling this sort of tax avoidance. Cracking down on transfer mispricing is incredibly important for nations across the world, especially for industrializing nations, and requires global action. Honouring our commitments to implement these OECD recommendations and pushing for further reform are opportunities for Canada to return to a position of leadership on the global financial stage.

Recommendation

ACFO strongly recommends that the government commit to reforming tax laws to end transfer mispricing and to implement the recommendations made by the OECD.

Value

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

⁴ Ibid.

⁵ http://www.taxfairness.ca/sites/taxfairness.ca/files/factsheets/corporate_tax_haven_chart_2015_0.pdf

⁶ <http://www.taxjustice.net/topics/corporate-tax/transfer-pricing/>

Step II: Finding new revenue sources

As discussed in the previous section, ACFO believes a large portion of the revenue needed to fund a progressive agenda can be found simply by collecting what is fairly owed. That being said, looking for alternative sources of revenue is good financial management practice.

Luckily the Government of Canada doesn't have to look too far. ACFO has one recommendation aimed at creating a new stream of revenue for the federal coffers and it's a model that's already in place in more than 40 jurisdictions around the world, including in the United States and the European Union.

Recommendation 3: Introduce a Financial Transaction Tax

Context

A Financial Transaction Tax (FTT) is slated to be implemented in the European Union later this year. A similar measure introduced in Canada could generate upwards of \$5 billion in revenue without materially affecting economic growth.⁷

An FTT would tax transactions between financial institutions, charging 0.5% against the exchange of shares and bonds and less across derivative contracts.⁸

To avoid any unwanted negative impact on the real economy, such a tax would not apply to normal financial activities of citizens and businesses (for example personal loans, payments, insurance and bank deposits); investment banking activities for the purpose of raising capital; transactions carried out for restructuring operations; or refinancing transactions with central banks.

In addition to generating tax revenue, an FTT would have the added benefit of serving as an effective curb on automated high frequency trading and highly-leveraged derivatives that contribute to market manipulation and instability.

FTTs exist in approximately 40 countries around the world (including many within the EU). A 2012 study concluded that these taxes generated \$38 billion per year.⁹

Recommendation

ACFO recommends that Canada follow the lead of our EU trading partners and adopt a FTT similar to the EU model that is going to be implemented later in 2016.

⁷ https://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2015/03/AFB2015_MainDocument.pdf

⁸ Ibid.

⁹ <http://stephanygi.net/papers/FTT.pdf>

Value

\$5 billion annually could be generated through the establishment of an FTT that is equivalent to a tax of \$5 on a transaction worth \$1,000

Step III: Preventing waste in government spending

Collecting what is owed and finding new sources of revenue would go a long way to ensuring the Canadian treasury can sustain the progressive agenda laid out for the next four years. However, as the ministerial mandate letters for the Minister of Finance and the President of the Treasury Board specify, cutting down on waste and funds lost through mismanagement is vital to ensuring an efficient use of these resources.

While not specifically a budgetary measure, we believe it is important to recognize and begin to tackle systemic barriers that are currently preventing some of this waste and mismanagement from being identified.

Recommendation 4: Review the PSIC mandate

Context

The Office of the Public Sector Integrity Commissioner (PSIC) was created in 2007 to investigate alleged wrongdoing in the public sector and to offer protection to those who expose misuse, waste or gross mismanagement of public assets. Upon its creation the plan was to review the enabling legislation after five years. Scheduled for 2012, this review is now four years overdue.

Canada's anti-corruption and whistleblower protection regime is among the best in the world and PSIC, particularly under the leadership of Commissioner Joe Friday, does great work within its mandate. But that mandate is unnecessarily limited and the protections afforded to those who do the right thing are wanting.

The connection to good financial management and budgeting principles here is clear. Public servants who are in a position to see wrongdoing and gross financial mismanagement, including ACFO's own members, need to feel as though they can raise concerns without fear of punitive retaliation. Anecdotal evidence from past whistleblowers shows that being vindicated by the system doesn't mean one is free from the harm of reprisal.

Recommendation

ACFO recommends that the members of the House Finance Committee push for the overdue legislative review of the PSIC enabling legislation. This review should begin immediately so that improvements can be made to the disclosure of wrongdoing and reprisal protection regimes in the federal public service.

Value

It's hard to quantify the value of this recommendation as we don't know how much waste or mismanagement is seen but not reported; however, recent experience has shown that even small instances of wrongdoing can add up to significant financial costs.

Conclusion

As the representatives of the financial management community in the federal public service, ACFO understands the importance of prudence and stewardship of resources. By following the steps and implementing the recommendations laid out above, we believe the government can fund its progressive agenda in a financially responsible way, all the while restoring fairness in the system.

Thank you for your time and consideration.