**CANADIANS FOR TAX FAIRNESS**
CANADIENS POUR UNE FISCALITÉ ÉQUITABLE

July 4 2018

Hon. Bill Morneau, PC, MP
Minister of Finance
Government of Canada
House of Commons
Ottawa Ontario
K1A 0A6

Sent by email to Bill.Morneau@parl.gc.ca and Bill.Morneau@Canada.ca

Dear Minister Morneau,

**Re: Canada's corporate income tax system and recent changes to the US system**

Canadians for Tax Fairness is a non-profit organization advocating for fair and progressive tax policies to build a strong and sustainable economy, reduce inequalities and fund quality public services.

Recent research by Canadians for Tax Fairness strenuously supported the Federal Government's effort in 2017 to close down inefficient and unfair tax loopholes.

We continue to engage in research and advocacy for tax fairness.

Our attached submission was designed as a resource to help our government avoid making unnecessary and damaging changes to our corporate income tax system in response to emerging US corporate tax policies. We hope you find our submission useful: "**Canada's corporate income tax system and recent changes to the US system".**

I look forward to your reply to the points raised in this document. Please feel free to call or write with any questions.

Yours truly,

Diana Gibson, Research and Communications Advisor
communications@taxfairness.ca 780-910-0665

# Canada's corporate income tax system and recent changes to the US system

## Submission to the Finance Minister of Canada

This Submission counters recent claims that Canada must urgently slash its corporate income tax rates and otherwise provide tax breaks to corporations in response to recent changes in the US corporate tax system. Our Submission also provides alternatives.

Our results show that:

- Claims of capital flight are unfounded in current data, and unlikely to materialize in the longer-term;
- Corporate tax cuts are not expected to have positive impacts on economic growth in the US or in Canada;
- Claims of a need for national "competitiveness" are based on misunderstandings of basic economics; and
- Corporate income tax cuts would cause fiscal and other problems for Canada.

We recommend that you take this opportunity to improve corporate tax policy in Canada, as follows: reining in tax policy competition, and fully addressing tax avoidance, tax evasion and money laundering.

**Capital exodus?**

Despite recent changes to the US corporate tax system, our Finance Minister recently confirmed that Canada's corporate taxes are still competitive with those of the US.[1] The difference in rates between the two countries is quite small, and unlikely to prompt massive changes in investment flow.

Ominous suggestions that investment capital would flood south of the border when the US tax changes came into effect - unsurprisingly - have not panned out. Canadian direct investment in the US in the first quarter of 2018 was actually less than half of the long-term average at $4.132

[1] J. Wingrove, "Canada's corporate tax rates remain competitive in spite of U.S. cuts, Morneau says," Financial Post, June 21, 2018 www.business.financialpost.com/news/economy/canadas-corporate-tax-rates-remain-competitive-in-spite-of-u-s-cuts-morneau-says.

billion,[2] while direct investment from the US to Canada was higher than the long-term average, at $7.899 billion. Not only were flows to Canada higher than average, and flows to the US lower than average; net investment actually flowed North!

This is unlikely to change in the longer term. Not only are Canada's corporate tax rates very close to the new US rates, but firms have many other reasons for their investment and location decisions such as:

- Proximity to markets for their goods and services;
- Proximity to supplies and suppliers (especially important in the case of extraction of immobile non-renewable resources);
- A well-educated and productive workforce;
- A superior and publicly-funded healthcare system that keeps business costs down;
- Longer-term exposure to future tax increases - a considerable risk when tax cuts massively drive up debt, as is forecast for the US; and
- The costs of relocation, including physical plant, supplier and buyer relationships, workforce turnover, transaction costs, amongst others.

**Finance Minister Bill Morneau:**

"We want to make sure we really understand those impacts but in the context of a broader and successful Canadian economy, in the context of a place where people want to come to and not only build a business but build a life."

Firms already take advantage of much larger tax differences in various jurisdictions. Our report on corporate use of tax havens,[3] shows that the biggest 60 companies on the TSX alone had well over 1,000 subsidiaries and related companies in known tax havens.

Given that some of these tax havens have CIT rates in the 0% to 1% range, and that Canadian firms are avid users, a modestly lower US tax rate is unlikely to cause a significant structural shift in corporate investment, because any shift that would generate additional profits has already occured.

Further, for those companies still reporting income and paying taxes in Canada and the US, there are many mechanisms to avoid paying the actual tax rate. After all their deductions and exemptions, a sample of the corporations listed on the Toronto Stock Exchange paid from just under two per cent to 16 per cent in 2014, far from the statutory rate of 26.5 per cent.

---

[2] Mean average since Q1 2007, the first year of data: StatCan Table 36-10-0025-01 (formerly CANSIM 376-0121).

[3] D. Gibson, "Bay Street and Tax Havens: Curbing Corporate Canada's Addiction" (Canadians for Tax Fairness, 2017). https://www.taxfairness.ca/sites/taxfairness.ca/files/pdf/canadian_for_tax_fairness_-_tax_havens_2017_nov_15_for_release.pdf.

**Tax cuts and economic growth**

The US corporate tax cuts are not expected to result in the US economy rocketing ahead while Canada's languishes. The IMF's April 2018 GDP forecast shows the current US lead in GDP growth dwindling by 2019; Canada's growth rate is forecast to mainly catch up by 2020, to surpass the US rate in 2021 by increasing margins each year after that.[4]

Cuts to corporate income tax rates cannot be expected to accelerate Canadian growth either. Additional stimulus at this point in the business cycle could be eaten up by inflation. Furthermore a recent Canadian study concluded that "there is no empirical or statistically significant relationship between the CIT regime and economic growth."[5]

**Canadian "competitiveness"**

Some of the perennial calls for tax cuts and tax breaks for corporations are based on an erroneous assumption that countries are in competition with one another. Calls for greater Canadian "competitiveness" reflect a lack of understanding of basic economic principles in relation to trade. If one country becomes more productive, then other things being equal, its trading partners will actually benefit - not be worse off.

Competitiveness and economic growth in Canada would be much better served by closing loopholes to ensure that corporations pay their fair share, and using those funds to invest in the social and physical infratructure needed for a modern, innovative high tech economy. Investments in research, technology, and innovation, reinforced by strong wage floors and labour standards, will help strengthen the long-term position of Canadian producers.

Investing in pharmacare will also give a boost to Canadian businesses by lowering the costs of employee benefits. Lowering corporate taxes only helps companies that are making large amount of profits while lowering payroll costs helps all businesses, including those who are struggling to survive. Corporate taxes cuts reduce revenue and make it more difficult for governments to fund pharmacare or other similar programs.

---

[4] IMF, World Economic Outlook Database, April 2018 https://www.imf.org/external/pubs/ft/weo/2018/01/weodata/index.aspx.

[5] J. Brennan, "Do Corporate Income Tax Rate Reductions Accelerate Growth?" (CCPA, 2015) https://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2015/11/Do_Corporate_Income_Tax_Rate_Reductions.pdf.

**Fiscal impact**

Cuts to corporate tax rates would have a significant impact on Canada's future deficits and debt, necessitating increases in other taxes, cuts to programs, or a higher level of tolerance for debt and debt servicing costs.

Advantages Canada offers over the US, such as our education and healthcare systems, cost money and require tax revenues.

In the end, those calling for urgent cuts to corporate income taxes must explain, in detail, how the resulting fiscal hole would be filled, the costs of doing so (financial, human well-being, political, etc.), and who would pay those costs. In this regard, vague suggestions for "efficiencies" are wholly inadequate.

**Positive steps for the Government on Corporate Income Taxes**

This is the time for our government to make positive changes to corporate income taxes.

***1. Rein in tax policy competition***

The Government should engage with other governments in a cooperative process to stop the race to the bottom on corporate taxes. If Canada and other countries were to slash corporate taxes, the US would face an incentive to do so again. And so on.

Policy competition is a destructive cycle of tit-for-tat tax reduction that leaves all countries worse off. It is actually a classic collective action problem, and the solution is always cooperation.

Canada has shown considerable leadership in addressing other collective action problems through international cooperation, ranging from reducing pollution emissions to containing the health impacts of tobacco. Canada should now engage in a major, long-term effort with other countries, as well as provinces, territories and cities within Canada to stop tax policy competition.

***2. Fully address tax avoidance and tax evasion***

Canada can, and should, step up its efforts to close loopholes and stop corporations from using tax havens and other mechanisms to avoid paying taxes. Conservative estimates are that Canada loses $10 billion to $15 billion in tax revenue each and every year from corporate use of tax havens.[6] This does not include other forms of corporate tax avoidance, nor tax avoidance by wealthy individuals. The impact on the public purse is significant. Many crucial programs could be fully funded if this problem is responsibly addressed.

It is time for Canada to adopt and enforce a zero tolerance policy for corporations illegally evading taxes owing. This requires a change in the law governing econmic substance (Bill C-362), and changes to international treaties, among other reforms. The budgets for monitoring and enforcement should be increased to the level that allows the government to address all instances of evasion, in order to send the necesssary pricing signals to corporations.

Corporations are the only true rational economic actor; they will - and indeed are required to - pursue a course that maximizes long-term profits and shareholder value. It has been documented time and time again, and in high profile cases, that corporations will take the lowest cost option when faced with the costs of compliance with the law vs costs of anticipated non-compliance penalties.

Non-compliance penalty costs depend on the probability of detection, enforcement proceedings, and court findings of liability,[7] and only with adequate budget can those probabilities be raised. The other factor is of course quantum of penalty, and the government needs to ensure that minimum and maximum penalties are set at a level that makes them salient in corporate decision-making (as opposed to a minor cost of doing business).

***3. Fully address money laundering***

Establishment of a national public registry for beneficial owners is a critical step for turning off the tap for illicit financial flows.

*Canadians for Tax Fairness acknowledges Diana Gibson and David Thompson of PolicyLink Research Canada, who provided research and analysis supporting this submission.*

[6] D. Gibson, "Bay Street and Tax Havens: Curbing Corporate Canada's Addiction" (Canadians for Tax Fairness, 2017). https://www.taxfairness.ca/sites/taxfairness.ca/files/pdf/canadian_for_tax_fairness_-_tax_havens_2017_nov_15_for_release.pdf.

[7] Anticipated penalty cost = probable fine quantum x risk of detection x risk of litigation x risk of adverse court finding.