OSLER

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**Sent by email to** minister-ministre@fin.gc.ca

**Department of Finance Canada**
**90 Elgin Street**
**Ottawa, Ontario K1A 0G5**

**House of Commons**
**Ottawa, Ontario K1A 0A6**

Dear Minister Champagne:

While recent discussions on Canada's economic competitiveness have rightly focused on critical infrastructure projects like pipeline approvals and the removal of interprovincial trade barriers, equal attention must be given to modernizing Canada's tax framework. The purpose of this letter is to describe specific and achievable tax reform proposals that we submit would reduce barriers to investment in and improve productivity across the Canadian economy. We would welcome the opportunity to discuss these with you or your Department of Finance and Canada Revenue Agency officials.

## Impediments that can and should be addressed immediately to help Build Canada Now

The Liberal Party's 2025 election platform included a commitment to conduct a comprehensive review of the corporate tax system in Canada as part of its administrative measures. This is a laudable objective; the last broad-based reform was in 1972 after the Carter Commission. However, the need to fund major infrastructure projects and grow production is urgent: Bill C-69 has introduced regulatory uncertainty, added new layers of risk, increased costs, and lengthened delays for major resource and infrastructure project approvals. This has created a chilling effect on investment, particularly in the energy and mining sectors, and has been widely criticized for undermining Canada's competitiveness and deterring capital investment-threatening national economic interests and job creation.

The removal of certain tax distortions that serve to exacerbate this chilling effect simply cannot wait for a comprehensive system review. We echo the urgency of the action plan in the "Build Canada Now" open letter to the Prime Minister signed by Canada's leading energy companies. In line with the action plan recommendations, targeted, immediately actionable tax measures would facilitate investment in critical energy infrastructure and the Canadian economy more broadly:

- **Facilitate debt financing by introducing a carve-out from the EIFEL rules for large infrastructure projects and real estate.** While recent amendments provide exemptions for certain public-private partnership (P3) projects, a broader carve-out is needed for major private sector infrastructure projects. Similarly, a carve-out is needed for investments in Canadian real estate similar to the rules in other jurisdictions, including the U.S. and U.K., so that Canadian real estate investment projects can remain competitive. The carve-out for investments in residential rental projects is insufficient.
- **Promote investment in Canadian equity markets by our largest institutions by restoring the dividends received deduction (DRD).** Almost 60 years ago, the Carter Commission recognized that corporate income taxes "distort the allocation of resources and reduce the value of our national output" and recommended that such distortion can only

be eliminated with full integration. The DRD for intercompany dividends was a critical component of integration until Budget 2023 announced the denial of the DRD for financial institutions making portfolio investments in taxable Canadian corporations. The denial of the DRD in this circumstance is a perversion of the economic foundation of the integration principle, and bad tax policy (particularly where the DRD is denied in the very circumstance where the investor is also subject to tax on accrued gains from its interests in corporations that remain subject to income tax).

- **Incent Indigenous and pension fund co-investment opportunities.** A genuine commitment to reconciliation in Canada should include tax measures making it easier for Indigenous groups to participate in energy projects. This includes revising the rules so that partnering with tax-exempts (pension funds, government funding bodies, and Indigenous groups) is not a cost to taxable parties. Moreover, such tax-exempt groups should be allowed to acquire more than 10% of a Crown corporation without causing the Crown corporation to lose its own tax-exempt status under ITA 149(1).
- **Reduce needless administrative complexity affecting inbound investment of expertise and monetary capital:**
    (a) Immediately address the needless burden of Regulation 105 withholding for Canadian and treaty-exempt subcontractors, which adds complexity to the administration and execution of almost every major infrastructure project.
    (b) Simplify the section 116 withholding regime by basing the withholding on the actual capital gain and significantly increasing the resources of the CRA section 116 team to allow firm commitments on timing for section 116 certificates, as the current prolonged (12+ month) process results in investable funds being tied up in escrow unable to be reinvested.
    (c) Remove technical barriers to relief from or refund of non-resident withholding tax by amending subsections 227(6) and (6.1).
- **Improve and streamline the CRA dispute resolution process:** Canada is at a competitive disadvantage compared to other jurisdictions in terms of the uncertainty and economic cost imposed on businesses by tax disputes. It is not unusual for it to take more than a year for a CRA appeals officer to be assigned to review a taxpayer objection even on a major matter, and it can take many more years to resolve tax disputes either within or outside of the court system. The timeline and costs to resolve tax disputes increase costs for doing business in Canada, especially those that qualify as "large corporations," and erode productivity and competitiveness and consequentially access to global capital. To that end, Canada should take steps to remove distortions that exacerbate the frequency and cost of tax disputes by:
    (a) Eliminating dual jurisdiction over tax matters: a single court of first instance should have oversight over all tax assessments and the Minister's conduct in connection with same as Canada's current split system (between the Tax Court of Canada and the Federal Court) causes confusion and delay for both the CRA and taxpayers.
    (b) Eliminating the rule that allows the Minister to collect 50% of a reassessment that is disputed by the taxpayer – a rule that is out of step with peer jurisdictions and creates an economic incentive and reward for the Minister to issue large reassessments even if they are ultimately unfounded, and imposes an undue burden on business.
    (c) Equalizing interest rates on arrears and refunds. At the very least, interest should be equalized during periods when assessments are under objection or appeal, or from inception in any circumstance where a taxpayer is required to pay a portion of the reassessment while it remains disputed – ensuring neither party is unjustly enriched or penalized while the dispute is ongoing.
    (d) Improving access to advance pricing agreements (APAs), as the CRA's approach is restrictive compared to peer jurisdictions.
    (e) Revisiting the role of TEBA (tax earned by audit) as a measure of the performance of a CRA audit team to at least also track tax reassessments that are reversed by the appeals division of CRA or by the courts, and thereby better acknowledge and address unduly aggressive and punitive auditor behavior.

## Modernizing Canada's tax system – a modest wishlist

Beyond the "low-hanging fruit" described above, we urge the Government to focus its attention on reducing needless complexity and uncertainty to promote investment and productivity. Although there are many areas of our tax system that would benefit from such reform, the balance of this letter describes the proposed measures that we believe would have the greatest impact.

1. **Recommit to the integration principle.** For many decades Canada's tax policy has recognized the need to integrate personal and corporation income taxes. The Carter Commission proposed a full integration system with the objective of removing the distortion caused by the corporate income tax so that "output would be greater so that some Canadians could be made better off without causing others to be worse off". This remains a sound guiding principle. At a minimum, restoring integration would include:

    (a) Rectifying the under-integration of corporate and personal income taxes in most provinces.

    (b) Reinstating integration in other provisions (e.g., deduction in respect of Part V1.1 taxes).

    (c) Enacting rules to allow for the consolidation of losses and other tax attributes within corporate groups.

2. **Repeal international tax measures that act as barriers to investment.** Canada has been a committed participant in the multilateral efforts of the OECD/G20 BEPS project and has implemented several international standards derived from its recommendations. However, these measures have been layered on to an already-complex system for taxing inbound and outbound investment, without a comprehensive review of existing measures (particularly measures that were designed to achieve similar results). The result is an unduly complex and overlapping patchwork of rules that create significant compliance and administrative burdens, act as barriers to inbound investment, and increase the risk and complexity of tax disputes. The thin capitalization rules and the foreign affiliate dumping (FAD) rules stand out as regimes that create extraordinary complexity, are inconsistent with international norms, can create unintended outcomes, and act as potential traps for the unwary. Given the objectives that these regimes share with the EIFEL rules and the potential overarching impact of the introduction of the *Global Minimum Tax Act*, these regimes should be repealed.

3. **Replace the complex foreign affiliate surplus regime with a participation exemption.** Canada's foreign affiliate rules provide double tax relief through a complex combination of exemption and credit mechanisms (including the exempt surplus, hybrid surplus, and taxable surplus regimes). This requires Canadian corporations to track multiple surplus accounts for each foreign affiliate, creating a significant compliance and administrative burden. Canada should reform its foreign affiliate rules by adopting a participation exemption system similar to the systems used by many European and other countries. A participation exemption could be used for both dividends and gains on sales of foreign subsidiaries (similar to the approach used by many European and other countries).

4. **Provide for cash pooling.** Canadian and foreign multinational companies often face difficulties when trying to include Canadian operations in international cash pooling arrangements. Canada's approach to cross-border cash pooling is different from other major economies and does not fully follow OECD guidelines. There are a number of provisions that potentially apply to cross-border cash pooling arrangements, including Canada's shareholder loan rules, upstream loan rules, back-to-back loan rules, thin capitalization rules, transfer pricing, etc. These rules should be updated to better match international standards and make cross-border cash pooling more feasible.

5. **Expand employee compensation regime to accommodate partnerships.** Many investors make investments in Canadian businesses through partnerships and wish to grant Canadian employees the right to share in the profits of the partnership in order to align their incentives with investors in the partnership. The stock option rules in section 7 of the ITA do not apply to interests issued by partnerships. As a result, the upfront grant of any such interest is generally taxable to the employee and there is often significant uncertainty regarding the value of such interest and the amount of the resulting employment income inclusion. Alternative structures that provide more

certainty to employees can be costly to implement and serve as a roadblock to commercial transactions and the creation of meaningful incentives for employees. The stock options rules should be expanded to afford similar treatment (in terms of timing and effective tax rate) to employees who receive interests in partnerships as part of their employment compensation.

6. **Simplify transfer pricing measures.** In June 2023, the Department of Finance released a consultation paper proposing amendments to Canada's transfer pricing rules. While including a draft re-write of the main rules that, as we submitted in the consultation process, would introduce uncertainty and potentially harm Canadian competitiveness, the paper also sought submissions on potential simplified rules and other administrative measures. There has been no update on such welcome measures since the consultation period closed.

    (a) Enact simplified transfer pricing measures, including safe harbours for Pillar One's Amount B and low value-added intragroup services (and clear guidance as to when these are available) and reduced documentation requirements for routine transactions.

    (b) Eliminate or limit the Minister's discretion over downward adjustments in subsection 247(10) (for example, by affording such discretion only in specific circumstances, such as where no corresponding upward adjustment will be made in the other jurisdiction) and provide an express right of appeal to the Tax Court for subsection 247(10).

    (c) Align Part I and Part XIII objections to treat a Part I objection as also constituting an objection to a related secondary Part XIII reassessment in the context of a transfer pricing adjustment.

    (d) Work with treaty partners that have opted in to binding arbitration as part of the multilateral instrument (MLI) to implement binding arbitration.

7. **Repeal the *Digital Services Tax Act* and revise the *Global Minimum Tax Act*.** Canada should reconsider its approach to legislative changes arising from multilateral projects overhauling the international tax system. In this regard:

    (a) Canada should repeal the DST, or at a minimum should (i) eliminate its retroactive application, and (ii) allow a tax credit for any DST taxes paid against ordinary Part I corporate income taxes. Otherwise, the tax rate on certain highly digitized businesses is unnecessarily increased above ordinary corporate tax rates. Moreover, the DST appears to be a major concern for the United States, unnecessarily exacerbating the current trade war and other proposed retaliatory measures.

    (b) Canada's proposal to introduce a UTPR in the *Global Minimum Tax Act* should be reconsidered – particularly in response to the retaliatory measures proposed by the United States. The cost of the U.S. retaliatory measures will significantly exceed any tax revenue that could otherwise be collected from that proposal. Moreover, Canada has acknowledged that the UTPR is inconsistent with Canada's tax treaty obligations (proposing to override our existing tax treaty commitments). The UTPR stems from flawed tax policy designed to force countries to participate in the Pillar Two regime – which has clearly not worked (since the U.S., China and many other countries are not participating). Canada should revise the GMTA to ensure that our rules are no less competitive than the U.S. GILTI regime. As the smaller economy, it is imperative for Canada's tax regime to be more competitive (not less competitive) than the U.S. regime.

    (c) Canada should work with OECD/G20 inclusive framework members to put into place a framework for multilateral dispute resolution in respect of global minimum tax in the GMTA.

8. **Reduce needless administrative complexity.** In addition to the measures described above, there are other opportunities to improve Canada's competitiveness by simplifying compliance and reducing needless administrative complexity. For example:

   (a) In addition to the suggestion above to eliminate Regulation 105 withholding in circumstances where there is no underlying potential liability or basis for withholding, work to eliminate Regulation 105 entirely. The rule is an outlier amongst peer jurisdictions.

   (b) Eliminate the complexity arising from having to designate certain dividends as being "eligible dividends" (which was initially designed to limit the expansion of income trusts prior to the introduction of the SIFT rules) – and ideally reduce dividend tax rates to better align with capital gains rates.

   (c) Simplify all tax reporting (particularly the T1134 reporting regime and other regimes that require an inordinate amount of largely duplicative information), so as to streamline reporting and eliminate duplication.

## Concluding remarks

We recognize that the government has many competing priorities. However, in our view the biggest priority should be to improve the economy – including by mitigating the impacts of the trade war with the United States, increasing the productivity of Canadian businesses, and encouraging investments in Canada. In our view, these proposals will assist in these objectives.

Yours very truly,

Osler, Hoskin & Harcourt LLP

**OSLER, HOSKIN & HARCOURT LLP**

c: Prime Minister Mark Carney

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