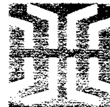
RECEIVED
6 JUN 24 2008



CADESKY AND ASSOCIATES LLP
CANADIAN AND INTERNATIONAL TAX SPECIALISTS

PARTNERS
MICHAEL CADESKY, FCA
GRACE CHOW, CA
HOWARD L. WASSERMAN, CA
PETER WEISSMAN, CA

PRINCIPALS
FRANK DE LISIO, CA·CBV
JONATHAN L. RICHLER, LLB
A. CHRISTINA TARI, LLM

May 6, 2008

e-mail: advisorypanel@apcsit-gcrcfi.ca
and regular mail

Advisory Panel on Canada's System of
International Taxation
Submission
333 Laurier Avenue West, 15th Floor
Ottawa, ON K1A 0G5

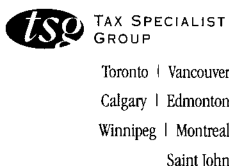
Attention: Peter C. Godsoe, O.C., Chair

Dear Mr. Godsoe:

I read with great interest the excellent preliminary report prepared by the Advisory Panel on Canada's System of International Taxation.

Our firm is a firm of Chartered Accountants and we specialize in tax consulting. Our clientele includes 300 smaller firms of accountants, for whom we act as a tax resource. We are part of an association of firms with offices across Canada who also service local accountants. As such, we are very familiar with the issues which arise on a daily basis in their practices, with respect to the international tax area.

We will be making a detailed and comprehensive submission to your Committee, with a particular focus on international tax issues relevant to smaller Canadian businesses and their professional advisors. However, I would like to provide some brief introductory comments at this stage regarding your report.

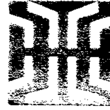

TAX SPECIALIST GROUP
Toronto | Vancouver
Calgary | Edmonton
Winnipeg | Montreal
Saint John

New York | London
Amsterdam | Hong Kong
Beijing | Shen Zhen
Macao | Düsseldorf
Paris | Marseille
Chicago | Rome
Milan | Copenhagen
Singapore | Sydney
Tel Aviv | Prague
Vienna | Zurich
Geneva | Brussels
Barbados | Nicosia

INTERNATIONAL TAX SPECIALIST GROUP

TAXPROS@CADESKY.COM
WWW.TAXSPECIALISTGROUP.CA
WWW.ITSGNETWORK.COM
WWW.CADESKY.COM

2225 Sheppard Avenue East, Suite 1001, Atria III, Toronto, Canada M2J 5C2 Tel: (416) 498-9500 Fax: (416) 498-9501
Toronto-Dominion Centre, Royal Trust Tower, 77 King Street West, Suite 2401, P.O. Box 93
Toronto, Canada M5K 1G8 Tel: (416) 594-9500 Fax: (416) 594-9501



Our comments draw on our experience with small and mid size businesses and advisors as well as high net worth taxpayers. Our initial thoughts are outlined below and you will note that they are focused, predominantly, on:

- Reducing complexity without compromising the tax base;
- Increasing compliance through reduced complexity and more assistance from CRA;
- Analyzing what areas of change and analysis can produce the best results for all stakeholders given limited resources at CRA and in the advisory community; and
- Investigating the tax effects of investing with our largest trading partner.

FIE Rules

The foreign investment entity rules have become extremely relevant to Canadians looking to conduct business outside of Canada, because of the involvement of Canadian private equity funds. Ten years ago, when these rules were first conceptionalized, one might have taken the position that these rules would be relevant only for purely passive types of investments (foreign mutual funds, etc.). This is not the case, in our experience, in today's market place. Thus, I would strongly encourage your Committee to study these rules as a centerpiece of your report. These rules, as presently drafted, are overly complex, and provide a disincentive to Canadians to commit funds to international businesses.

I believe it might be useful for your Committee to consider the foreign outbound area as a spectrum which has at one end wholly-owned foreign corporations and controlled-foreign affiliates, then foreign affiliates, and finally foreign investment entities and portfolio investments. The tax issues differ across the spectrum.

Lastly, it would be helpful to see projections on the revenue to be raised from the FIE rules, the number of taxpayers affected, the compliance costs to the public and to the Canada Revenue Agency ("CRA"), and what the current system produces.

FAPI

I was extremely pleased to see that a review is going to be conducted into Canada's FAPI system. May I suggest that you explore the statistics that may be available in this area, such as the number of taxpayers who report FAPI, the amount of FAPI which is reported, and the tax which is paid on this FAPI, after giving a deduction for the "grossed-up" foreign tax?

May I point out that your report indicates that a credit is given under the FAPI system for foreign taxes (see for example paragraph 2.28), whereas in fact what is given is a modified deduction.

May I also suggest that your report consider the degree of double taxation which arises under the FAPI system, which ironically becomes larger as the tax paid in the foreign jurisdiction increases? I have made some calculations of this, which I would be pleased to share with the Committee if this is useful to you.

I would like to highlight the importance of considering the tax cost of repatriating foreign income to Canada, especially by private corporations, and, in particular, where the income is FAPI. Significant double taxation results, to the detriment of Canadians looking to invest outside of Canada. FAPI has a tax avoidance connotation, but this is not really the case. For example, a Canadian with a U.S. rental property held in a U.S. corporation or LLC will have FAPI and almost 60% tax by the time earnings are repatriated to Canada.

Complexity and Administration of the System

An international tax system of a country with a comprehensive income tax system will never be simple. Having said this, the Canadian tax system is unduly complicated in many areas. As your report notes, reducing complexity is an important objective without creating an erosion of the Canadian tax base.

Of concern to smaller Canadian businesses and their professional advisors is the lack of guidance provided by the CRA in the international area. Canadian corporations are expected to keep track of the surplus accounts of their foreign affiliates, for example, yet there are no forms for this computation. Also, Canadian businesses are expected to note whether or not they have FAPI, yet there is no interpretation bulletin or guide which can be referred to for assistance.

The degree of complexity of the international sections of the *Income Tax Act* (sections 90 to 95, 113 and 126 especially and related regulations) is sufficient to overwhelm most full-time, experienced income tax practitioners, let alone generalists. Appropriately designed guides, forms, and interpretation bulletins would go a long way to making this complexity manageable. In my view, CRA has totally failed in this area. Investigating why this is the case (e.g. limited

resources within CRA or lack of internal consistency in interpretation) could go a long way to improving support for taxpayers, advisors and the tax system.

It has also been our experience that CRA sometimes unfairly targets smaller businesses which have international operations, contending that they have no "business substance", because they are thinly staffed and frugally financed. Often these fledging businesses grow to become sizeable. There is generally a view that CRA discourages the setting-up of international operations by smaller Canadian corporations, perhaps because they are "easy targets". This leaves the international area to the domain of larger enterprises, which is unfair.

Taxable Canadian Property

Your report has extensive material concerning Canadian inbound investment. You raise a number of very valid questions concerning withholding taxes and thin capitalization. However, you have not explored in any detail the Canadian taxation which results on a disposition by a non-resident of a Canadian investment.

As you are aware, Canada has extensive rules dealing with taxable Canadian property, which subject Canadians to tax on gains realized from the disposition of certain Canadian assets. In many cases, Canada's right to tax is overridden by an international tax treaty.

May I suggest that it would be useful to review the system for the taxation of dispositions of taxable Canadian property which is currently in place? I believe it would be instructive to obtain certain statistical information concerning, in particularly, the amount of tax raised from the disposition of taxable Canadian property by non-residents, and apportion this between real estate and non real

estate assets. It may turn out that much of the system is wasting resources, given that, in many cases, Canada's international tax treaties override the domestic law. The burden on the compliance certificate staff at CRA is well documented and recent budget proposals may only provide band aid assistance while there are options that can result in compliance but less burden on CRA and taxpayers.

U.S. Investment

Your report does not generally deal with investment from any particular country or region. However, it is clear from the table of withholding taxes in section 4 of your report that approximately two-thirds of non-resident withholding taxes are collected on payments to the U.S. Allowing for the fact that withholding tax rates between Canada and the U.S. are lower than those under most treaties, and significantly lower than the non-treaty rate, one might conclude that 70% to 80% of all payments of dividends, interest, rents and royalties made from Canada to non-residents are to the U.S. Given the enormous significance of the U.S. to the Canadian economy, I wonder whether you should specifically deal with U.S. investment as a topic on its own.

Inconsistent treatment of various hybrid entities by Canada and the United States makes integration of the systems more difficult than ever.

In addition, the U.S. tax system has certain particular features which might be considered in the design of Canada's international tax system. To the extent that Canada could make available to U.S. taxpayers the ability to take a credit for Canadian tax, this would clearly make an investment in Canada more attractive. Put another way, a U.S. investor (whether an individual, private business or public company) will look at the Canadian tax system quite

differently if Canadian tax can be offset against U.S. tax, rather than being an absolute cost which cannot be recovered. Surely then, in attracting U.S investment, it would make sense to create a tax system which is attractive and accommodating to U.S. investors, especially if this could be done with no loss of Canadian tax revenue (and possibly the reverse).

Conclusion:

Thank you for your time in considering these points. I would be pleased to discuss these matters in more detail with a member of your Committee, if that would be useful to you. In any event, we will be making a more detailed submission to you, after surveying the accounting firms to whom we consult, on a number of issues that have been raised in this letter.

Once again, I would like to compliment you and your Committee on your work so far.

Yours very truly,

Michael Cadesky, FCA, TEP
Partner – Taxation
\vr