

July 16, 2008

Peter Godsoe, Chair
Advisory Panel on Canada's System of International Taxation
333 Laurier Avenue West, 15th Floor
Ottawa ON K1A 0G5
Via email: advisorypanel@apcsit-gcrefi.ca

Dear Mr. Godsoe:

RE: FPAC Submission to the Advisory Panel

The Forest Products Association of Canada (FPAC) is pleased to have the opportunity to provide the perspective of the forest products industry on Canada's business climate and system of international taxation.

FPAC is the voice of Canada's wood, pulp and paper producers nationally and internationally in government, trade and environmental affairs. Canada's forest products industry is an \$80 billion a year industry that represents 2% of Canada's GDP. The industry is one of Canada's largest employers, operating in hundreds of Canadian communities and providing nearly 900,000 direct and indirect jobs across the country. FPAC represents the largest Canadian producers of forest products. Our members are responsible for 75% of the working forests in Canada. FPAC members welcome outside scrutiny of their forest management practices to ensure that they meet the highest standards. In fact third-party certification of member companies' forest practices is a condition of membership in the Association -- a world first.

Overview

The Panel's Consultation Paper accurately and appropriately characterizes the importance of ensuring that Canada's business climate attracts investment and facilitates the competitiveness of Canadian companies both at home and abroad. In Canada, we make our living through trade. Some 70% of Canada's GDP comes from international trade. As one of the world's largest and most successful trading nations, Canada must aspire to be a leader in developing a business climate that encourages and facilitates trade.

Canada's international tax system is a key element of this business climate, and we urge the committee to take a broad view of its mandate and one that keeps the focus on competitiveness. The economic challenges facing Canadian industry, particularly forestry and manufacturing, are unprecedented. The confluence of a Canadian dollar at parity, sustained and aggressive competition from emerging economies and the collapse of the US housing market have created a perfect storm. Canadian governments cannot be complacent. They need to act much more

quickly to improve the business climate in Canada, not just to position Canada among the middle of the pack but at the head of the pack. While we recognize the need to be cognizant of the revenue impact of proposals, FPAC encourages the Advisory Panel to take an approach in its recommendations that promotes the expansion of Canada's global trade relationships.

In this regard, the recent report of the Competition Policy Review Panel emphasized the need for Canada to take a regulatory stance that encourages competition and then allows Canadian firms to compete. FPAC welcomed the Review Panel's report and publicly supported some of its recommendations. In particular, FPAC supports the Panel's recommendations to:

- Make the Canadian tax system more competitive;
- Put the primary focus on Canadian competition law on the enforcement of anti-competitive behavior rather than on concerns about industry concentration;
- Address Canada-U.S. border thickening as the number one trade priority; and,
- Create a Canadian Competitiveness Council to advocate for competition and keep governments focused on national competitiveness.

Specific Issues

The following issues are of most concern to the forest products industry.

Interest Deductibility of Foreign Affiliate Financing

It is important to recognize that the new rules under the "Anti-Tax Haven Initiative" do represent an improvement from those originally proposed in the 2007 Budget. However, there is still widespread concern among tax experts – practitioners and academics alike – that the initiative is too restrictive and in stark contrast with historical policy objectives.

FPAC remains concerned that the measures adopted may still negatively impede investment both into and out of Canada. Specifically, the industry is concerned that the initiative will increase the cost of foreign direct investment (FDI) to Canadian companies and will correspondingly reduce the competitiveness of Canadian firms and restrict the emergence of strong globally oriented Canadian companies.

Foreign direct investment creates strong "national champions" with robust head office functions, that are more likely to invest in research, training and to create spin-off economic benefits in related industries such as equipment and finance. Larger, stronger Canadian companies can withstand greater challenges by global markets and continue to support the communities in which they operate.

Faced with an unpredictable dollar, growing international competition, market dominant customers and the costly softwood dispute, many Canadian forest products companies have invested outside of the country in an effort to leverage their domestic operations and improve their global competitiveness. Foreign expansion provides the size and capabilities necessary to better seize market opportunities. Without size, companies may not be able to reach economies

of scale required for today's markets. For example, large customers such as Wal-Mart or Home Depot are increasingly demanding that their suppliers can serve them on a continental basis.

Foreign expansion can also provide a hedge against regional volatilities – such as exchange rate fluctuations, regional input prices and supply, trade disputes, and other risks. In the forest products industry, recent examples include Canfor and West Fraser which have recently invested in US operations. These investments create more diversified, stronger Canadian companies. In these specific cases, they also allow companies to plan more effectively to cushion the impact of the Mountain Pine Beetle epidemic in British Columbia and Alberta.

The Initiative directly increases the cost of capital for foreign investment by restricting financing structures beyond what is accepted in competing jurisdictions. In addition, the Initiative will indirectly increase the cost of capital by increasing the compliance burden of individual corporations involved in foreign financing of any structure. This may be particularly problematic for companies with no existing foreign presence since higher risk premiums may make it more difficult to borrow abroad. In general, the Initiative will place Canadian firms at a disadvantage relative to our competitors in other countries, as the Canadian tax rules will be less favourable. The previous provisions relating to interest deductibility were consistent with best practice international tax policy and were intended to minimize regulatory burden and avoid double taxation. FPAC looks to the Advisory Panel to take full opportunity to comment on the new measures and any potential solutions to resolve this issue.

Regulation 105

Regulation 105 is a provision of the *Income Tax Regulations* that requires a withholding tax on payment for services performed in Canada by non-residents. The Regulation 105 withholding tax regime represents an inappropriate and punitive administration burden for industry. The primary weakness of the current Regulation 105 regime is its treaty-based waiver provisions. Waivers may be provided to treaty country non-residents if an application is made at least 30 days prior to the commencement of services or initial payment. Waiver applications must be approved by a Tax Service Office, which is the reason for the 30-day application timeframe.

In contrast, the US process is much more flexible. The US requires a non-resident service provider to file a simple, one-page form (W8-BEN) with the payer prior to payment in order to claim the benefit of a reduced treaty withholding rate. A significant difference from the Canadian waiver regime is that the form is not filed with the IRS and does not require any prior approval. The form provides the payer with sufficient evidence that the payer may rely upon in good faith to reduce the withholding tax to the applicable treaty rate and the exemption remains valid for 3 years or better.

Inappropriate requirements, like those imposed by the administration of Regulation 105, add costs to Canadian industry. While the costs associated with Regulation 105 may not singularly have a dramatic impact on competitiveness, the collective impact of it and many other regulatory requirements does. It is important to address these issues individually and collectively in order to improve Canada's competitive position.

At a minimum, Canada should replace its onerous waiver process and adopt a simplified reporting system to ease taxpayer administrative burdens and to eliminate many of the

compliance difficulties experienced by non-residents. A process aligned with the requirements imposed upon Canadians under the US system and those of our other significant trading partners may be appropriate.

Transfer Pricing

As the international marketplace becomes increasingly integrated and more companies operate in multiple jurisdictions, the frequency with which the issue of transfer pricing arises increases and its treatment becomes more complex. Add to this heightened security concerns and the potential for barriers to commerce and investment increase.

Complying with Canadian documentation requirements can be complex and overly burdensome and is compounded by foreign jurisdictions that often require different documentation. Moving to one common documentation requirement among our major trading partners (such as the United States, Japan etc.) could achieve a considerable improvement over the current situation. This is particularly important for the forest products industry given the level of integration between Canada and the U.S. However, earlier proposals under the Pacific Association of Tax Administrators (PATA), which includes Canada, U.S., Japan, Australia) were unacceptable as the contemporaneous documentation requirements would increase the compliance burden on industry.

FPAC member companies have struggled through a sometimes, long and protracted transfer pricing process. Advance Pricing Arrangements have not been entirely successful at avoiding compliance irritants. Other compliance irritants have also surfaced between tax authorities in Canada and foreign jurisdictions and the competent authority process, and between Canada Border Services Agency (CBSA) and Canada Revenue Agency (CRA). FPAC requests the Panel to explore opportunities to improve the transfer pricing process to reduce the compliance burden and to facilitate better information exchange between the CBSA and CRA.

Conclusion

Due to a confluence of challenges, Canada's forest products industry is currently facing one of the most difficult periods in its long history. However, the longer-term fundamentals driving the global demand for forest and paper products are strong – the only real question is whether Canada can position itself to serve the growing global market. The answer depends on us – industry, government, labour and other stakeholders in the Canadian industry.

The Advisory Panel has taken a good first step with its Consultation Paper's solid characterization of the pressing need to enhance Canada's business and investment climate. Now, it is critical to follow through with a series of recommendations that will make Canada a much more attractive location for investment.

The Competition Policy Review Panel has recognized the pressing need for an improved business climate in Canada and set out an ambitious agenda that provides a blueprint for action. FPAC looks to the Advisory Panel to make equally ambitious recommendations. Indeed, the two

Panels can complement each other's work providing the federal government a breadth of sage advice to enhancing Canada business and investment climate.

Summary of Recommendations

- FPAC encourages the Advisory Panel to take an approach in its recommendations that promotes the expansion of Canada's global trade relationships.
- FPAC looks to the Advisory Panel to take full opportunity to comment on the new measures and any potential solutions to resolve concerns of the restricted treatment of foreign affiliate financing interest deductibility.
- Canada should replace its onerous waiver process under Regulation 105 and adopt a simplified reporting system to ease taxpayer administrative burdens and to eliminate many of the compliance difficulties experienced by non-residents.
- FPAC requests the Panel to explore opportunities to improve the transfer pricing process to reduce the compliance burden and to facilitate better information exchange between the CBSA and CRA.

FPAC wishes to thank the Panel for the opportunity to submit the views of our members and we look forward to the release of the final report. In the interim, feel free to contact our office to discuss this submission.

Sincerely,

A handwritten signature in black ink, appearing to read 'Paul Lansbergen', with a long horizontal flourish extending to the right.

Paul Lansbergen
Association Secretary,
Director, Taxation & Business Issues