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Woodbridge

July 22, 2008

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

Attn: David Messier

Dear Sirs/Mesdames,

Re: Submission of The Woodbridge Company Limited to the Advisory Panel on Canada's System of International Taxation

The Woodbridge Company Limited[1] is pleased to make this submission in response to the consultation paper, *Enhancing Canada's International Tax Advantage*, provided by the Advisory Panel on Canada's System of International Taxation in April, 2008.

<u>Creating centres of information and technology excellence in Canada</u>

This submission[2] focuses on maintaining, attracting and building Canadian information and technology industries. A key way of accomplishing this objective is to

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[1] The Woodbridge Company Limited, a private company, is the primary investment vehicle for members of the family of the late Roy H. Thomson, the first Lord Thomson of Fleet. Woodbridge is the controlling shareholder of Thomson Reuters, and also owns the largest (40%) stake in CTVglobemedia. Woodbridge also has substantial private equity investments and real estate holdings in Canada and internationally. Thomson Reuters, the shares of which are listed on stock exchanges including the Toronto Stock Exchange, is the world's leading source of intelligent information for businesses and professionals, and employs more than 50,000 people in 93 countries. CTVglobemedia owns the CTV and A-Channel television networks, numerous specialty channels including TSN, Bravo! and MuchMusic, 35 CHUM radio stations, and The Globe and Mail.

[2] Thomson Reuters has also prepared a submission. That submission, unlike this one, focuses on specific issues that pertain to Thomson Reuters.

encourage investment in Canada by those wanting to market intellectual property[3] arising from or used in information and technology businesses. The Competition Policy Review Panel in its report of June 2008, *Compete to Win*, emphasizes the importance of intellectual property to the success of information and technology businesses:

> The Panel recognizes that intellectual property frameworks play a central role in rewarding and encouraging innovation by granting creators the rights that enable them to monetize the products of their innovation. This is particularly so for knowledge-based industries in the contemporary global economy.[4]

The successful development of intellectual property in knowledge-based industries in turn requires Canada to attract people who are at the forefront internationally in their fields, including scientists, engineers, and those with expertise in marketing information and technology. Having a critical mass of expertise within Canada creates a virtuous circle. The development of intellectual property that has proven international applications in turn attracts more expertise to Canadian businesses and universities, which in turn leads to the development of more successful intellectual property. The Competition Policy Review Panel stresses the importance of attracting a core of highly qualified people in today's economic environment:

> In the knowledge-based economy a skilled workforce is critical to attracting and retaining investment. For Canadians with strong education and training, the reward for meeting the economy's changing and rising labour market requirements is the opportunity to pursue good jobs and rewarding careers.[5]

The particular importance of developing strategies to attract a pool of qualified people in research and development, while at the same time recognizing the pressures to reduce research and development costs, is confirmed in the most recent (2007) OECD report on international investment perspectives:

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[3] This term covers copyright, which typically also covers computer software, patents, trademarks, trade secret rights and industrial design rights.

[4] Industry Canada, *Compete to Win: Final Report of the Competition Policy Review Panel*, 2008, p. 94, available at: www.competitionreview.ca.

[5] *Ibid.*, p. 66.

> The escalating costs of R&D investments, in particular in science-based industries, and increased global competition for innovation, have necessitated moves to reduce R&D costs while speeding up the development process. This has led firms to rely more on external sources of innovation, using a range of strategic instruments, such as strategic alliances, mergers and acquisitions, corporate venturing, and R&D outsourcing. Foreign R&D investments to create new technologies is part of the response, as firms need to get access to centres of excellence in scientific and technological development as well as to pools of talented scientists and engineers at lower cost.[6]

<u>Use of Canada's international tax system to create centres of excellence</u>

Canada's domestic tax regime already provides one key means of accomplishing this objective, with its well developed system of tax credits for research and development. The importance of this system for the development of intellectual property in Canada, and the need for monitoring that system, is recognized by the Competition Policy Review Panel, which has recommended as follows:

> The federal government should monitor the scientific research and experimental development tax credit program annually in order to ensure that business investment in research and development and innovation in Canada is effectively encouraged.[7]

Canada's international tax system has a valuable additional role to play in encouraging specifically the development of intellectual property. Once a particular item of intellectual property has been developed, it is typically licensed in consideration for a royalty. If that intellectual property is developed in, and then marketed from, Canada the royalty income is subject to full tax in Canada. Therefore, an investor considering whether or not to establish a centre for the development of intellectual property in Canada will be drawn to jurisdictions that have educational standards and an overall development level similar to Canada's, but a more attractive international tax regime for the licensing of intellectual property. Those jurisdictions already exist[8], and indeed other jurisdictions

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[6] OECD, *Report On International Investment Perspectives: Freedom Of Investment In A Changing World.*, 2007, p. 158, available at: www.oecd.org.

[7] Industry Canada, *op. cit.*, p. 95.

[8] Ireland for example provides an exemption from Irish tax in respect of patent royalties and other income received for the use of patents where the research and development work in relation to the patent has been

are increasingly turning to targeted tax incentives in areas that they wish to encourage, including activities that give rise to royalties. The OECD points to this trend in its 2007 report, *Tax Effects on Foreign Direct Investment*:

> Rather than reducing the burden of tax provisions of general application, certain countries prefer to explicitly target tax relief with the aim of encouraging additional FDI at a lower cost in terms of foregone tax revenue. Targeting mobile activities . . . is regarded by some policy makers as an attractive option. In considering reductions in the effective tax rate on the most mobile elements of the tax base, the tax treatment of interest and royalty income is increasingly under review, with some countries indicating the dependence of their future policy actions on the actions of others.[9]

The report adds:

> . . . there are indications that policy considerations including the mobility of capital and business calls for more lenient home country treatment are leading many if not most countries towards more lenient treatment, not less, across a broader set of income types, because other countries are doing the same.[10]

Consistent with this trend and its implications for decisions made by businesses as to where to locate their operations involved in the development of intellectual property, the appropriate role for Canada's international tax system is in providing additional encouragement for the development of intellectual property and the associated centres of excellence in Canada. This is accomplished by an approach that focuses on the tax implications of the exploitation of that property outside Canada. This approach has a number of beneficial effects. It attracts businesses from outside Canada that are drawn to Canada by the tax rates and, as the centres of excellence develop, by the existence of those centres, for purposes of development and commercialization of their own intellectual property. This approach also encourages Canadian companies that may

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carried out in Ireland. Examples of other OECD jurisdictions with special regimes for income from royalties, or capital gains, from intellectual property include France, Belgium and Luxembourg.

[9] OECD Tax Policy Studies, *Tax Effects on Foreign Direct Investment: Recent Evidence and Policy Analysis*, 2007, p. 15, available at: www.oecd.org.

[10] *Ibid.*, p. 21.

otherwise consider moving their intellectual property or related assets outside Canada to retain that property, together with related offices and jobs, in Canada. Finally, this approach encourages Canadian companies that acquire intellectual property outside Canada, for example through acquisitions of foreign businesses, to migrate that intellectual property to Canada for purposes of further development in Canada and commercialization.

The most effective and simplest means of adopting this approach is to reduce significantly the rate of Canadian tax on (or to provide a deduction for a significant portion of) all royalties received from outside Canada from the exploitation of intellectual property developed in Canada, as well as to reduce significantly the rate of Canadian tax on capital gains from the disposition of that property. The effective rate would be set by taking into account foreign tax that would otherwise be payable if similar types of royalties were earned, or similar types of capital gains were realized, in other OECD countries that have chosen to reduce or eliminate tax on those types of royalties and capital gains, and would recognize the fact that costs of developing the intellectual property in Canada would be deductible in Canada against other income.

There is always a risk that once Canada establishes such a system of incentives, other jurisdictions will make their own systems even more attractive, giving rise to what has been referred to as a "race to the bottom" in which countries compete with each other to provide ever lower tax rates in specific areas. However, with its proximity and access to the US market, together with its size and education network, Canada can attract businesses with incentives that are at least as attractive as those offered by other jurisdictions. Once businesses are established in Canada, there will be little incentive to move even if other jurisdictions provide more attractive incentives.

The Consultation Paper asks, on page 22, whether Canada should treat interest and royalties from a foreign affiliate in the same manner as dividends. The recommendation in this submission is not confined to royalties from foreign affiliates. If a particular item of intellectual property is developed in Canada and licensed to a customer outside Canada, the resulting royalties should, consistent with the objectives set out above, be taxed in Canada at a reduced rate regardless of whether the customer is related or unrelated.

The Consultation Paper on page 5 sets out, among other objectives, the desirability of (i) attracting foreign investment, (ii) maintaining and enhancing the competitiveness of Canadian businesses operating abroad, and (iii) certainty and simplicity in tax legislation. Dealing with royalties in the manner recommended has the advantage of meeting all three of these objectives. Non-Canadian companies would be attracted to Canada as a jurisdiction from which they would have an incentive to develop their intellectual property in Canada and to market it globally from Canada. The position of Canadian information and technology businesses operating abroad would be enhanced if they could market their intellectual property directly from Canada. Finally, dealing with royalties in the manner proposed has the advantage of being focused on one type of income and is less complicated than alternatives such as adjusting research and development tax credits.

<u>Overall objective</u>

Because the Panel is concerned with Canada's international tax system, this submission has necessarily focused on a particular means of using that system to encourage the development of centres of excellence in the information and technology area. Of course, there are many non-tax measures that would have the same effect, some of which are referred to in the report of the Competition Policy Review Panel.[11] However, even those non-tax measures have an important impact on Canada's tax position. This is because, taken together with the recommendations in this submission, they would increase Canada's tax base both by attracting new skilled employees and by encouraging the establishment of new knowledge-based businesses in Canada.

These changes have the overall objective of ensuring that Canada can build on its existing strengths to become a leader in the knowledge-based world economy and the home base of businesses that are global champions in it. The importance of this objective cannot be overstated. Canada's competitors now include not only the United

States and Europe but other countries that are rapidly developing their expertise in the information and technology sector. Canada can prevail. But if it is to do so, the Government of Canada must make this objective a high priority and do everything in its power to ensure that it is achieved.

Further contact

Woodbridge would be pleased to expand on this submission or to answer any related questions the Panel may have. Any queries should be addressed to:

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(416) 364-8700

Yours truly,

THE WOODBRIDGE COMPANY LIMITED

W. Geoffrey Beattie
President

[11] See in particular the recommendations in Industry Canada, *op. cit.*, p. 95.