

This year's AGM is scheduled for Wednesday, the 28th of March 2007 at 12:00 at the Vancouver Club.

Please call 604-683-6626 to reserve a place.

### The IFC BC's 12th Annual Golf Tournament scheduled for Tuesday, June 12, 2007!

The 12th Annual Golf Tournament will have a different format this year.

#### What's Different

- Type: Shotgun, all groups will start and finish together.
- Starting Time: All groups will tee-off at 1 p.m.
- Format: Modified Texas Scramble, where the best first drive starts (minimum of 4 per player) and then each player plays their own ball.

#### What's the Same

- Location: The tournament will be held at Morgan Creek in Surrey.
- Price: \$185 per player in spite of cost increases by Morgan Creek.
- Dinner: Starting at about 7 p.m.
- Hopefully, the weather!



## Reflecting on the *International Financial Activity Act (IFAA)*

by Ron Bozzer

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*It has been two and a half years since the Province of British Columbia passed the International Financial Activity Act (IFAA). While progress has been steady, more work needs to be done to encourage international financial businesses to locate in British Columbia.*

The *IFAA* introduced two major changes in registration requirements for international financial businesses. First, any Canadian corporation transacting a qualifying international business can apply for favourable tax treatment by registering to undertake eligible activities under the *IFAA* program. This effectively widened the pool of eligible applicants to the entire corporate community where previously it was limited to regulated financial institutions under the *IFB (Tax Refund) Act*, the predecessor legislation. Second, the arm's length requirement was largely eliminated, and most non-arm's length transactions now qualify for favourable tax treatment.

A year after the *IFAA* was legislated, the government of British Columbia passed an amendment adding the commercialization of life science patents to the list of eligible activities. The purpose was to further stimulate the growth of this important sector as the government recognized that the *IFAA* could be used as a vehicle to drive strategic economic objectives.

Not only has broadening the *IFAA* resulted in more members registered under the *IFAA* program, but it has contributed to the expansion and diversification of international activity in British Columbia. For example:

- The number of members registered under the *IFAA* has increased by over 83%.
- Prior to 2004, 100% of *IFAA* registrants were financially-based institutions and asset managers. Now 65% are financially-based and 35% represent other industries, such as forestry, pulp and paper, life sciences, manufacturing, and pharmaceuticals.
- The qualifying activities which companies choose to register reflect the broadened scope of the *IFAA*. At the end of 2006, over 18% of the firms registered in the *IFAA* program were active in international factoring or treasury op-

erations, 5% in biotech, and 5% were actively engaged in administrative or back office functions that support an international activity.

These positive results are evidence that the work accomplished over the last two years by the Province and the International Financial Centre British Columbia, supported by the efforts of the major accounting and law firms, is beginning to bear fruit in what we hope will be a growing influx of international companies establishing operations in British Columbia. Many corporate executives in other parts of the world are beginning to see that British Columbia offers not only lower costs, but also a unique international orientation.

The progress that has been made, however, can and should be accelerated—particularly in cases where British Columbia already has a competitive advantage. Our competitors, including for example, other Canadian provinces, are nipping at our heels. This is not the time to be tentative. British Columbia should make full use of the *IFAA* to advance its strategic economic policy and encourage new business in sectors identified for growth, such as energy and environment, waste management, wireless communication, and new media. The *IFAA* can also be used to increase activity in areas where growth has been lacking—such as financial institution activity. Eliminating the capital tax levied on large financial institutions, at least for banks registered under the *IFAA*, will help level the playing field in Canada and make British Columbia competitive with other provinces who have wisely eliminated it.

Most importantly, bold policy initiatives that directly impact economic growth in British Columbia send a clear signal to global corporations that British Columbia is open for business and welcoming of the international business community.



## Current Issues in Taxation

### Thoughts on Restructuring Canada's Tax System

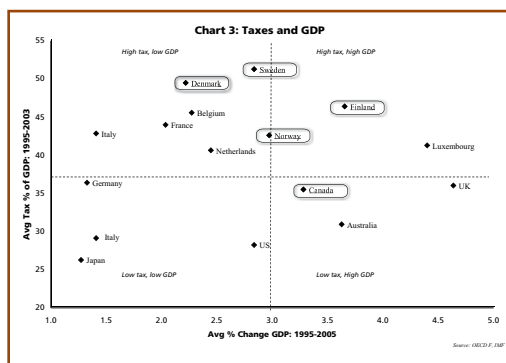
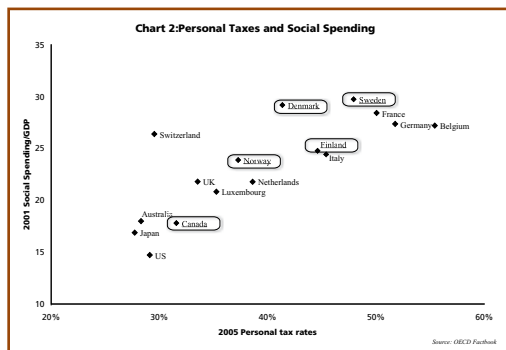
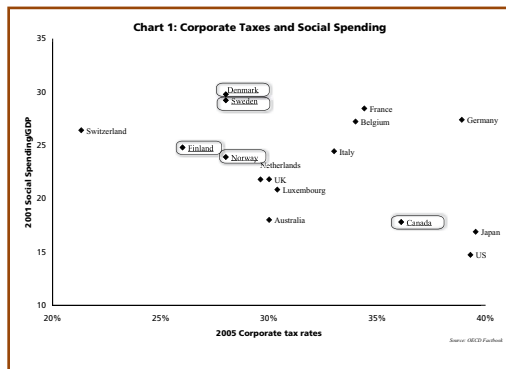
Recently the C.D. Howe Institute and the Fraser Institute issued reports stating Canada's tax system is, if not in need of a complete overhaul, then at least in need of serious repair. According to Jack Mintz, author of the C.D. Howe's *2006 Tax Competitiveness Report*, Canada is in trouble. It's effective tax rate on capital—tax paid as a percent of pre-tax returns on investment—ranks sixth highest among industrialized countries. At 36.6%, Canada's tax on capital is over 6 percentage points higher than the average 30.9% of other industrialized countries. According to Mintz, "Taxes on capital investments have the most powerful effect on Canada's productivity — the ability to produce more with the same resources — compared to all other taxes. Without business investment, companies will not be able to improve wages paid to workers since less production is forthcoming from their efforts. More importantly, businesses fail to adopt new innovative technologies to improve their products or processes if they do not invest in capital." (Mintz, *2006 Tax Competitiveness Report*, C.D. Howe Institute, 2006).

Recent reductions in federal and provincial taxes have resulted in a drop in Canada's effective tax rate on capital from 39.1% in 2005 to 36.6% in 2006—but planned future decreases will not be enough to keep Canada abreast of other industrialized countries. Mintz suggests that Canada consider adopting the dual income tax system of the Nordic countries. Under this structure, income would be divided into two components: capital and labour. Capital would then be taxed at a low flat rate and labour at a progressive rate.

With such a structure in place, it is obvious that investment would increase as the cost of capital decreased, but it is perhaps less obvious what would happen to the labour market. The assumption that increased labour taxes would result in a decline in labour supply has not necessarily been borne out by the research. While degree and parameters regarding wage elasticities are in contention, most researchers agree that for working men wage elasticities are very small and may even be negative. In other words, an effective wage decrease, as would occur with an increase in labour taxes, would not necessarily be reflected in changes in employment behaviour (Devereux, Paul;

### Industrial and Labor Relations Review; April 2003.)

And what about social spending? If the corporate tax rate was reduced, won't spending on services such as education and health care suffer? As shown in Charts 1 and 2, social spending is highly correlated to personal tax rates and appears inversely related to corporate tax rates. Denmark and Sweden rank the highest in social spending as a per cent of GDP while Canada, with its higher corporate taxes and lower personal taxes, lags behind.



Mintz's analysis, however, fails to answer the vital question: how does the economic performance of the Nordic countries compare to other OECD countries? As shown in Chart 3, plotting a nine-year average of taxes as a % of GDP against the average change in GDP from 1995 to 2005 shows that, with the exception of Finland, GDP growth of Nordic countries has been lower than Canada's, although this may be the result of other policies, such as labour regulations, as suggested in a recent *Financial Post* article on Sweden. (Foster, *Sweden's Fatal Irony*, *Financial Post*, 2007.)

A study by the Fraser Institute tackles tax reform in a different way. According to the report, *Tax Efficiency: Not all Taxes Are Created Equal*, Canada should reduce its reliance on personal and corporate income taxes and offset the difference with increased taxes on sales, social security, and payroll. (Clemens et al., *Tax Efficiency: Not All Taxes Are Created Equal*, *Fraser Institute*, 2007). Among 30 industrialized countries, Canada's income and profit taxes account for 46.5% of Canada's government revenue compared to 34.4% of other OECD countries. On the other hand, Canada relies on consumption taxes for 25.9% of its total revenue compared to an average of 32.3% for other OECD countries.

The report recommends that instead of taxing personal income at a progressive rate, as seen in Nordic countries, personal income rates be lowered and the difference offset by higher taxes on consumption. In addition to a more efficient administration and collection system, increased reliance on consumption and payroll taxes benefits all since these taxes are less costly to society than capital or the return on capital.

In spite of their differing structures, both reports agree that corporate taxes in Canada are too high. The concept of overhauling the tax system is gaining ground as it becomes clear that having corporations bear a disproportionate burden of tax impedes productivity growth. And, as the Fraser Report comments, if reform is needed, now is the time. "Canada is currently enjoying a prolonged period of economic success. The country has an opportunity to re-balance and improve its tax system by bringing that system more in line with those of our chief competitors." (*Ibid.*, p.22)