

INTERNATIONAL BUSINESS ACTIVITY ACT

STATUS OF THE INTERNATIONAL BUSINESS ACTIVITY PROGRAM

This note could be addressed as part of Budget 2018.

I. ISSUE

Whether to eliminate the *International Business Activity Act* income tax refund program.

II. BACKGROUND

A May 2, 2017 *New York Times* article (provided in Appendix 1) brought attention to BC's *International Business Activity Act*. The Act refunds the BC income taxes paid by corporations that conduct international business from BC. In response to this article, the then-NDP leader and current Premier committed to refer the program to BC's Auditor General for review, with a view to potentially eliminate the program.

In 1987, the federal government enacted legislation in its *Income Tax Act* designating Vancouver and Montreal as international banking centres. Any profit earned on loans to or deposits from non-residents would be exempt from corporate income tax. The program was a response to Canadian banks moving their head offices from Montreal to Toronto; BC requested that Vancouver also be included in the program. In 2013, the federal government eliminated its program in order to simplify Canada's tax system, improve tax fairness and remove any perception that the program created an international tax haven.

BC introduced the *International Financial Business (Tax Refund) Act* in 1987 to complement the federal program and grow Vancouver's international financial sector. Like the federal program, BC's program effectively ensured program participants' profit from international business would be exempt from BC corporate income tax.

However, the scope of qualifying international financial activities of the BC program was broader than the federal program. Subsequent expansions further broadened the program to include international film distribution businesses and international patent businesses¹, and permitted non-arm's length financial activities, such as transactions between a parent corporation and its subsidiary or between members of a corporate group (Appendix 2 contains full eligibility

¹ For international patent businesses, the tax refund is capped at \$8 million or 75 per cent of the company's BC tax relating to its international business, whichever is less.

details). Despite these expansions, 99 per cent of all refunds are in respect of international financial businesses.

In addition, BC provides personal income tax refunds to eligible corporations' immigrating employees (known as "specialists"). Specialists can receive a full income tax refund for their first two years in BC, and partial refunds in their third, fourth and fifth years.

In 2016/17, 65 companies participated in the program, which cost \$20 million. It is forecast to cost \$25 million in 2017/18, 2018/19 and 2019/20. The cost is primarily due to the refund of corporate income taxes; (\$58)

Companies in the program are required to be members of AdvantageBC. Annual registration with Advantage BC costs \$1,000 plus 0.45 per cent of income earned on international business to a maximum of \$80,000. AdvantageBC uses these funds to promote BC as a location for investment, including promoting the International Business Activity program.

DISCUSSION

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Despite the International Business Activity program's existence for 30 years,
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The International Business Activity program provides a refund of income taxes paid rather than a tax credit based on the salary and wages of the business. This means there is no direct link between the cost of the program and the employment it generates. In contrast, Quebec (the other jurisdiction targeted by the original federal program) converted its program to a non-refundable income tax credit based on the salary and wages paid by companies.

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The only internal review of the program was done in 2010 by the Ministry of Finance's Tax Policy Branch. This review used actual tax refund information to estimate employment and GDP related to the qualifying international business

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s.13 ~ BC's combined federal-provincial general corporate income tax rate is 26 per cent (roughly half of the 51.57 per cent rate in 1987 when the program was introduced). Because of this, KPMG ranked Vancouver second in its 2016 guide to international tax competitiveness, ahead of the traditional financial centres of London, New York, Singapore, Hong Kong and Tokyo.

BC's Auditor General performs an annual audit of the tax programs administered by the Ministry of Finance's Revenue Division, including the International Business Activity program. The audit focuses on administrative processes, and does not analyze whether a program is effective.

IV. OPTIONS

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V. EVALUATION

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VI. RECOMMENDATION

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VII. DECISION

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Appendix 1: New York Times article

British Columbia's Business Temptation: An Opaque Array of Tax Breaks

By Dan Levin

May 2, 2017

VANCOUVER, British Columbia — British Columbia is well known for its spectacular landscape and outdoorsy living, its swanky urban real estate and bouillabaisse of cultures.

A fact not so well known? It has a sweet deal for businesses, offering them tax breaks in an unusually opaque arrangement.

Like many places, British Columbia set up a system of tax incentives to lure businesses to the far western Canadian province in the hopes of creating jobs and transforming Vancouver into a global financial center.

But if the program has been good for business, it's been less beneficial for British Columbia.

Participating companies have created few jobs, according to government figures, while more than 140 million Canadian dollars (\$106 million) have been doled out in tax refunds since 2008, when the initiative was expanded.

The incentives operate under a cloak of secrecy that is unusual for similar efforts in Canada and the United States, critics say. The province will not name the companies that get the breaks. The only information available about them is on the website of a nonprofit that promotes the program.

"This is essentially a temporary foreign-worker program for the rich, with secret government subsidies for multinational corporations," said Dermot Travis, the executive director of IntegrityBC, a nonpartisan political watchdog group based in Victoria, the provincial capital. "The government is selling B.C. as a tax haven for the global elite to park investment here, but not have to contribute."

The provincial Ministry of Finance, which runs the effort, says it is a success, with 82 companies participating. Jamie Edwardson, a spokesman for the ministry, declined in an email to identify those companies or discuss the amount of refunds each has received, citing a ban on publicly disclosing taxpayer information in the law that created the incentives. He said the law protects taxpayer privacy.

At one point, the tax breaks were projected to create more than 13,000 jobs in British Columbia. According to ministry figures, though, fewer than 300 have been created as a result of the program, and possibly as few as 122.

To illustrate the plan's success, Mr. Edwardson pointed to decade-old data in a consultant's 2009 economic analysis, which estimated that between 2001 and 2007,

the additional investment added anywhere from 124 million to 141 million Canadian dollars — between \$91 million and \$103 million — to the economy. Mr. Edwardson said these figures were the most recent available.

Experts say that with few public details, it is hard to tell whether the plan is worth the lost tax revenue. They also say the lack of disclosure prevents the public from knowing if companies are using the province as a pit stop on a global quest to avoid taxation. "There's a real concern corporations are just stripping money out of places," said Michael Knoll, a law professor and a director at the University of Pennsylvania Law School Center for Tax Law and Policy. "This lack of transparency is aiding that process."

The secrecy is unusual, experts say. A comparable tax-incentive plan in Montreal makes more information public, records show, including the names of participants.

In the United States, it is standard practice for state governments to release the names of companies receiving targeted tax breaks, including credits and rebates. Most states also share other information about participants that British Columbia does not, like the amount of money each company has invested and where that investment has gone, along with what the state has received in return, said Greg LeRoy, the executive director of Good Jobs First, an American nonprofit that tracks state tax-break programs.

The International Business Activity Act, initially passed in 1988, allows companies to claim a refund of up to 100 percent of their provincial corporate income taxes on a number of business activities, including lending, foreign exchange trading and investment management, which could bring a company's tax rate down to 15 percent.

Over the years, the plan was expanded several times. In 2010, an expansion allowed high-paid nonresidents of Canada who work in British Columbia for participating companies to receive new generous tax breaks unavailable to Canadian residents.

The tax breaks favor foreigners in other ways, too. Companies can receive refunds on real estate activities with foreigners, including mortgage loans on property in Canada for international buyers. Conducting the same domestic activities for Canadians would not qualify for the refunds. This has raised concerns that the tax refunds may encourage banks and other companies to prioritize foreigners over Canadians in Canada's overheated housing markets.

The ministry runs the program. But the law that set it up requires participants to join and help finance a nonprofit, AdvantageBC, established in 1986 to promote British Columbia as a business destination. AdvantageBC advises its members on how to benefit from the tax breaks. The involvement of this group has also become a target for critics.

"There is no reason for this organization to be outside of government," said Duff Conacher, a founder of Democracy Watch, a Canadian civic organization, "except to escape the ethics, transparency and accountability requirements government institutions have to face."

Colin Hansen, a former provincial finance minister who helped expand the program's tax incentives in 2010, is president and chief executive of AdvantageBC. He defended the group's involvement in the tax-break program. "On all issues, we are fully accountable to our members, which is where that accountability should be," he said in an email.

As finance minister, Mr. Hansen repeatedly declared that expanding the program would help attract companies doing international business and "create those jobs in British Columbia."

In a recent interview, though, he said that its goal was really to enlarge the local financial services sector. "The program was not actually set up to be a job creator," he said.

Mr. Hansen said most of the companies listed as "core members" on the group's website were registered in the program. But he also said that some companies joined the group before seeking the benefits. He declined to provide a complete list of businesses. "Some companies are a little more sensitive about being included," he said.

It is unclear which businesses listed on AdvantageBC's website are in the program and receiving tax breaks. But a company must be a core member to get the refunds.

Provincial officials have praised the tax breaks as a boon to economic ties between China and British Columbia, and have devoted significant time and political capital in recent years to tailoring it to Chinese investors and the financial institutions that cater to them.

In 2014, the province expanded the program for foreign banks, which it said would raise the potential for investment from Asia, especially China. "These amendments to the International Business Activity Act send a strong message to foreign companies that B.C. welcomes their business, setting the stage for increased investment," said Michael de Jong, the finance minister, according to a government news release.

Mr. de Jong declined to answer questions about the program, including whether the public should be able to know which companies are receiving the tax breaks.

Several of the businesses listed on AdvantageBC's site are Chinese, including the Bank of China and a subsidiary of China Poly Group, a Chinese state-owned conglomerate. The companies did not respond to requests for comment on whether they had received any tax breaks.

PacNet Services Ltd., a payment processing company, had been a core member of AdvantageBC since at least 2006. In September 2016, the United States Treasury Department listed PacNet as a significant transnational criminal organization for its "lengthy history of money laundering," and froze the company's American assets. The company has denied the accusations. Rosanne Day, PacNet's president, declined to comment on whether the company was in the tax-incentive program and has received benefits.

After inquiries by The New York Times, PacNet, two associated companies that have also been sanctioned and several other firms were removed from AdvantageBC's website last month. Mr. Hansen later said they were no longer members.

Appendix 2: Eligible International Businesses

International Financial Business

Almost all corporations that qualify for the International Business Activity program qualify as an international financial business (99 per cent). To qualify as an international financial business, all the activities of the business must be international financial activities. The following are international financial activities under the program:

- Accepting or making deposits in any currency as principal in a debtor-creditor relationship.
- Making loans or borrowing in any currency as principal in a debtor-creditor relationship on an arm's length basis only.
- Guaranteeing the payment of a debt, if all of the debtors or all of the creditors of the debt are non-residents.
- Dealing in short-term debt securities (excluding derivatives) as principal by a non-securities corporation.
- Dealing in securities (including derivatives) as agent for a non-resident of Canada.
- Providing financial advice, other than legal, accounting or tax advice. Legal, accounting or tax advice that can reasonably be considered ancillary and incidental to the financial advice is allowed.
- Insuring risks, other than life, sickness or accident insurance, on an arm's length basis only, of or relating to non-resident persons and relating to property or events outside Canada. Captive insurance companies are exempted from the arm's length requirement.
- Managing, for a fee or commission, foreign exchange activities.
- Managing, for a fee or commission, investments.
- Managing for residents, for a fee or commission, investments in securities issued by a non-resident that are not listed on a Canadian stock exchange.
- Preparing stock market or other financial research for the exclusive use of non-residents, other than legal, accounting or tax research. Legal, accounting or tax research that can reasonably be considered ancillary and incidental to the financial research is allowed.
- Factoring, which is collecting trade accounts receivable where the accounts are receivable from a non-resident and have been purchased from a resident or non-resident without recourse.

- Collecting, for a fee or commission, trade account receivables from non-resident persons.
- Leasing property, by means of a direct financing lease as defined in the Canadian Institute of Chartered Accountants Handbook.
- Providing administrative support services directly related to a financial activity of a non-resident financial business. Call centres, marketing and advertising are excluded by regulation. An internal support function, such as a computer help-desk providing direct services to non-resident employees is not considered a call centre but an administrative support service.
- Providing back-up office services, which are providing services, equipment and premises to continue the business operations of the non-resident in the event their primary equipment or premises become temporarily unusable.
- Handling import and export letters of credit at arm's length, including documentary and standby letters of credit and documentary collections, where not more than one party to the underlying transaction is a resident of Canada.
- Dealing in securities (including derivatives), as principal, with a non-resident if the corporation is either a savings institution or other corporation registered under the Securities Act as a dealer or underwriter (other than capital stock of the corporation or its affiliates).
- Dealing in securities (including derivatives), that are not listed on a Canadian stock exchange as agent of a resident, with a non-resident if the corporation is either a savings institution or other corporation registered under the Securities Act as a dealer or underwriter (other than capital stock of the corporation or its affiliates).
- Dealing in foreign exchange, where the corporation's primary business is dealing in foreign exchange on an arm's length basis only.
- Acting for a fee or commission exclusively for non-resident persons:
 - as trustee of a trust that, at all relevant times, is non-resident,
 - as an executor or administrator of the estate of a non-resident person, all the beneficiaries of which are at all relevant times non-residents,
 - as guardian of the estate of a minor who is non-resident, and
 - as committee of the estate of a mentally incompetent person who is non-resident.
- providing services in respect of the *Immigration and Refugee Protection Act (Canada)*, and

- providing services in respect of that person seeking leave to enter, extend stay or remain indefinitely in the United Kingdom as an investor.

International Film Distribution Business

An international film distribution business is a business carried on by a corporation through a fixed place of business in BC where all of the revenue is derived from one or more of the following transactions:

- selling, assigning or licensing rights to a non-resident person to distribute outside of Canada a film or television production (other than pornography), or
- selling, assigning or licensing rights to a non-resident person to exploit outside of Canada anything related to the film or television production.

International Patent Business

An international patent business is a business carried on by a corporation through a fixed place of business in B.C. where all of the revenue is derived from one or more of the following transactions:

- selling, assigning or licensing to a non-resident person, a patent within an eligible class of patents, or
- selling to a non-resident person, a good or service in respect of which the sales revenue is principally derived from an invention for which a patent within an eligible class of patents is owned by the corporation.

INTERNATIONAL BUSINESS ACTIVITY ACT

FOLLOW-UP INFORMATION ON POTENTIAL PROGRAM ELIMINATION

This note could be addressed as part of Budget 2018.

I. ISSUE

This note provides further information regarding the International Business Activity (IBA) program and seeks a decision on whether to eliminate the program.

II. BACKGROUND

On July 28, 2017, the Minister of Finance requested more information regarding the IBA program. This note provides additional information on the following topics:

- case studies of transactions that qualify for the program,
- implications for AdvantageBC,
- legal risks of eliminating the program,
- stakeholder groups affected by eliminating the program,
- administration costs associated with phasing the program out, and
- timing considerations.

III. DISCUSSION

Case studies

The examples below illustrate the types of transactions that occur under the IBA program.^{s.13}

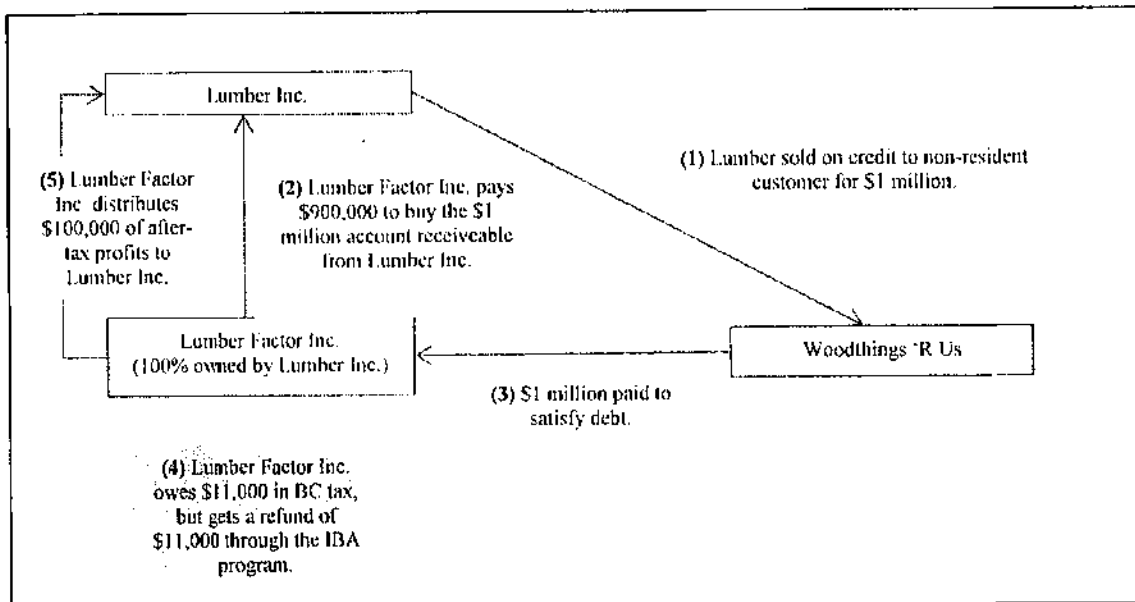
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Factoring

Factoring accounts for 29 per cent of all refunds since 2009 with an annual cost of \$6.3 million. Factoring occurs when a business sells its accounts receivables to another company (the "factor") at a discount. The factor will collect the accounts receivable and generate profit if the amounts collected exceed the price it paid to acquire the accounts.

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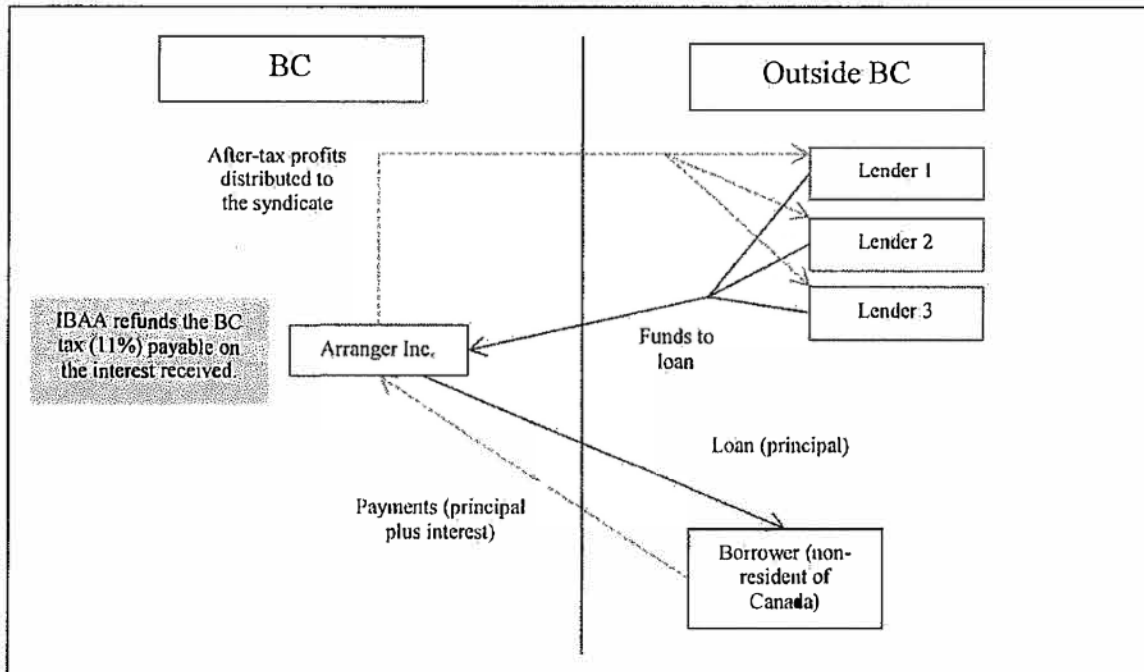
In this case study, Lumber Inc., a BC forestry company, reduces its total BC tax bill by \$11,000 by setting up Lumber Factor Inc. to qualify for the IBA program. Lumber Factor Inc. will collect on Lumber Inc.'s accounts receivable. There is no incremental activity in BC because the parent, Lumber Inc., would collect its accounts receivable itself in the absence of the IBA program. Moreover, Lumber Factor Inc. may use Lumber Inc.'s resources, including its accounting systems and employees.



Syndicated loans

Some banks with branches in BC qualify for the IBA program by issuing syndicated loans to non-residents. Unlike ordinary loans, syndicated loans involve very large amounts and require a group of lenders (called a "syndicate") to provide the funds. Syndicated loans are much larger than ordinary loans,^{s.13}

In an example of a syndicated loan, foreign lenders incorporate a company in BC, Arranger Inc., to issue a loan such that any income from the loan is funnelled through Arranger Inc. and qualifies for an IBA refund. Very little activity or employment is generated by Arranger Inc. in BC; the bulk of the activity and employment in respect of the syndicated loan (e.g. finding the borrower, negotiating the terms of the loan and providing the capital) is done in traditional financial centres such as New York or Toronto. Arranger Inc. will distribute the after-tax profits to the syndicate members outside of BC.



Computer-controlled trading

Due to increased computing power and advancements in software engineering, financial transactions are increasingly being done without the involvement of human employees. Dealing in foreign exchange as well as managing investments for a non-resident person are two activities that qualify for the IBA program in which computer-controlled trading has become prominent.

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The reliance on computers means that neither investment management nor foreign exchange dealing generate significant incremental employment in BC.

Implications for AdvantageBC

AdvantageBC (formerly called IFC Vancouver) was established in 1986 with the creation of the IBA program. It acted as an industry association, including lobbying activities. Originally, the IBA program was promoted by government and IFC Vancouver was funded by government. In 1996/97, for example, it received \$300,000 in government funding.

In Budget 1998, the government required that international financial institutions be members of IFC Vancouver to be eligible for an IBA refund. According to the budget announcement, "This allows IFC Vancouver to expand its membership

and negotiate membership fees which will increase the degree to which the organization is self-funded. Increased self-funding will increase IFC Vancouver's independence and strengthen its ability to effectively represent the membership.”

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Legal risks of eliminating the program

Governments have the right to remove tax incentives.^{s.13,s.14}
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Stakeholder groups affected

The following is a list of the 10 largest IBA refund recipients from 2014 (the most recent year with audited data available),^{s.13}^{s.13}

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Note: The following information is protected under the *International Business Activity Act* and cannot be shared with anyone outside the Ministry of Finance. S.58

Administrative costs

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Timing considerations

If the government wants to eliminate the IBA program, a variety of effective dates are feasible.

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IV. OPTIONS

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V. EVALUATION

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VI. RECOMMENDATION

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VII. DECISION

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