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Ottawa defends tax haven crackdown

NEW YORK — Finance Minister Jim Flaherty defended proposed measures to crack down on offshore tax havens yesterday, after coming under fire from critics who say they would limit businesses' ability to expand abroad.

In the 2007-08 federal budget, presented on Monday, Flaherty proposed to close a tax loophole that allowed firms to deduct the interest payments on borrowed money used to acquire shares of foreign affiliates, saying it had allowed some companies to abuse the tax system unfairly.

When questioned on the measure at a business luncheon in New York yesterday, Flaherty said: "This is an issue with respect to which we felt we had to act."

"The issue with respect to tax havens is something that has been festering for a long time and no action was taken. The tax leakage from those schemes is very substantial to the treasury and its not justifiable in terms of fairness to other taxpayers in the country."

Flaherty was in New York to flaunt Canada's status as the only Group of Seven nation with a budget surplus and promote his economic plan to investors, to be followed by stopovers in London and Tokyo in coming weeks.

He said the risk to Canada's healthy economy from the U.S. housing slowdown is only "moderate," adding he sees cause for optimism in Canada's struggling manufacturing sector.

"To some extent, the housing problem in the U.S. has been regional," Flaherty told Reuters earlier on Friday in an interview.

"There has been some decline in the U.S. housing market but it hasn't been precipitous. It's manageable," he said.

But, despite the strong fiscal footing, businesses and international organizations have urged Ottawa to reduce corporate taxes and cut down on bureaucracy.

One election promise that was sorely missed in the budget was a reform to the capital gains tax. Flaherty vowed to fulfill the promise but would not commit to a timeline.

"I can assure Canadians that during the course of our mandate we'll keep our commitment," he said.

He was referring to the Conservatives' full five-year mandate but the minority government is widely expected to go into an election this year, after winning the January 2006 election. The Conservatives hold only 125 of the 308 seats in the House of Commons and must rely on the support of at least one opposition party to stay in power.

Flaherty's budget has enough opposition support to pass and the minister said he does not expect Prime Minister Stephen Harper to force an election any time soon.

CANADA-U.S. TAX TREATY

One step that will reduce the cost to Canadian business, according to Flaherty, is the elimination of a withholding tax on interest payments between Canada and the United States, to be contained in a revamped Canada-U.S. Tax Treaty that will be signed within three months.

"We have completed negotiations on the principles. I hope we can sign the Canada-U.S Tax Treaty in 90 days," he said.

Canada's economy has come under strain from the U.S. softness. Manufacturers, hit by that slowdown as well as by a strong Canadian currency and rising Asian competition, also got some help from Flaherty in the form of a two-year write-off for investments in machinery and equipment.

"There have been some job losses but there has been a strong survival instinct among our manufacturers," Flaherty said. "Now we've given them this shot of adrenaline over the course of the next two years so I think they've got what it takes to succeed."

But some of his promises of lower taxes for businesses depend on action by provincial governments. Flaherty praised Ontario for eliminating its capital tax as part of its own budget released on Thursday.

"I'm happy to see that. The corporate tax rate in Ontario is one of the highest in North America," said Flaherty, himself a former Ontario finance minister.

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