The Banks' Statutory Income Tax Rate

The Statutory Federal Income Tax Rate was legislated at 50 per cent in 1972, the year of Canada's Tax Reform. It was then reduced by 1 per cent per year until 1976, when it reached 46 per cent. In 1980 the Federal surtax of 5 per cent was imposed, raising the Statutory Tax rate to 48.3 per cent in 1982.

Provincial tax rates, which vary from 15 per cent to 11 per cent, depending on the province, have the effect of raising the "statutory" rate, according to the premium attributed by the province to the taxable income. In order to compute the provincial tax payable, a bank may deduct from its Federal Tax 10 per cent of its taxable income earned within that province. Consequently, tax rates, in total depending on the province, range from 48.3 per cent to 51.0 per cent, which is referred to as the "overall statutory income tax rate".

Foreign Income Tax Paid

Canadian banks expanded their banking operations into the international sector during the early 1970s. By the end of that decade, the largest of the Canadian banks were established as respected international banks with first class credit ratings in the money markets of the world, and were able to compete for business along with the other major international banks. (Prior to the 1980 Bank Act revisions, Canadian banks were refused permission to establish branches in many countries due to the lack of reciprocity granted by Canada.) Profits from foreign banking operations, as previously noted, have increased to 47 per cent of total after-tax income in 1981, from 17 per cent in 1971.

Canadian banks have moved abroad in order to be accessible to foreign clients, to be more sensitive to changes in local markets, to enhance communications and to provide services for Canadian exporting companies. The banks have tended to establish branches abroad, rather than set up subsidiaries, largely because depositors and borrowers prefer to deal directly with the parent institution. More recently, however, there has been some growth of banking operations through subsidiary companies.

The establishment of foreign branches and subsidiaries also has considerable tax implications. Taxation is a major factor in determining whether the operations in a certain country will be performed by a branch of the bank concerned, or by a subsidiary. Tax planning is therefore essential in establishing the proper organization to survive in the highly competitive area of international banking.

Most of the taxation problems banks face in operating in foreign countries can be traced to the withholding tax of 15 to 25 per cent the Government of Canada levies on total interest earned by foreigners from Canadian sources. As a result of the withholding tax, Canada has signed tax treaties with about 35 other countries which insist on a similar rate, even though many do not tax bank interest crossing their borders into countries other than Canada. Canadian tax law therefore allows any income tax paid to a tax treaty country as a credit against Canadian income tax. If Canadian banks did not receive credit for these foreign taxes they pay, they would not be able to compete internationally. A separate calculation must be made for each country, so that the income from that country bears an