THE CANADIAN CHAMBER OF COMMERCE
LA CHAMBRE DE COMMERCE DU CANADA

The Voice of Canadian Business™
CONNECT! BRANCHÉ!
Le porte-parole des entreprises canadiennes MD

Policy Brief

Taxation Proposals from Finance

Issue:
The government has proposed the most radical changes in the treatment of Canadian controlled private corporations in 50 years, including (1) a new tax (effectively 73%) on investment income in a corporation, (2) a much higher tax rate for compensation in a family business deemed "unreasonable," and (3) new, tougher rules for converting income to capital gains.

Impact:
There is a significant and growing groundswell of opposition from small business and from local chambers. Small business owners across the country are concerned the tax changes will:

- unfairly prevent them from building up retirement savings;
- lead to lower savings within their businesses, eroding sustainability and future investment for business growth;
- make it more difficult to pass down ownership of family-run businesses to the next generation (an issue that may also affect larger CCPCs); and,
- result in more intrusive, costly audits by CRA.

Business owners are also irate about the "stealthy" approach the government has taken to consultation, its vilification of legitimate small business entrepreneurs as "tax cheats" and the government's insistence that business owners do not know what they are talking about.

Objectives:
Our ultimate objective is to have the government revise its proposed tax measures so the ability of business owners to save within their companies for purposes of retirement or business growth will not be affected. We want to position the Canadian Chamber as a constructive voice and the chamber network as a communications channel for the government to better understand the concerns of business owners.

Background:

- On July 18, the government launched a 70-day consultation (ending Oct. 2) with the release of a document entitled, *Tax Planning Using Private Corporations*. Minister Morneau's public remarks, as well as our discussions with Finance officials and the fact that the tax proposals contained draft legislation, all indicated the government intended to proceed with the changes irrespective of what it heard in consultation.
- That is why we launched a campaign asking chambers and businesses to email their members of parliament. We formed a coalition with 58 other business associations calling on the government to put the tax proposals on hold so we could have a more thorough review of the tax policy.
- Currently, the government is digging in. On Sept. 12, Prime Minister Trudeau said, "A lot of those wealthy folks are really fighting to keep those benefits that they have, and they're making a lot of noise." Minister Morneau said his goal is to ensure there are not "two classes" of Canadians facing different tax rates based on whether they have incorporated a small business or they have not. He repeatedly ruled out extending the Oct. 2 consultation deadline.

- Officials in Minster Morneau's office have told us they are open to some minor "tweaks" but are firm in going through with all the tax measures because "fairness" is an important issue to them and was a central part of their election platform.
- Although Finance is moving full steam ahead, the pressure is building on MPs and caucus. Most recently, the Chair of the House Finance Committee said the government should "step back" from the changes and undertake a more fulsome consultation.

Work to Date:

- Key messages, analysis of tax changes and business concerns were circulated through the chamber network and are available on our website for coordinated communications. These materials are available at http://www.chamber.ca/advocacy/hot-topic-corporate-taxes/
- Op-ed in *National Post*—basis for local chamber media
- Joint letter with other business associations to Minister Morneau
- Lead for the Coalition of Tax Fairness (56+ associations)—coordinated communications and advocacy. Can be viewed at http://smallbiztaxfairness.ca/.
- One-on-one discussions with PMO, Minister Morneau, Minister Chagger's Chief of Staff, MPs and senators
- Minister Morneau invited to attend AGM
- Chamber meetings being held across Canada—Finance officials, MPs, Senators invited

Moving Forward: Policy and Advocacy Plan

- Resolution and media event at AGM
- Submission to Finance consultations—focus on "unintended consequences"
- Launch of new website, http://protectgrowth.ca, with messaging on how the proposals will hurt economic growth and job creation—that is what matters to Canadians and small business is the engine of Canada's economy
- Local chamber meetings with officials, MPs and senators through to October (25+ planned)
- Meetings with MPs and senators when parliament resumes in Ottawa
- Meetings with key departments: Finance, SME, PMO
- Coordinated communications and advocacy with coalition of associations
- Messaging shift to how the proposals will hurt economic growth and job creation—that is what matters to Canadians and small business is the engine of Canada's economy

Additional Details and Questions on Business Impacts:

The government insists it is targeting high-income individuals who are misusing tax "loopholes," but such sweeping changes will have major impacts on businesses across Canada in a wide variety of sectors, from farming and restaurants, to technology and consultants.

1. Income sprinkling: Finance expects to raise $250 million by applying a higher tax rate on "unreasonable" compensation of family members. This would require CRA to tax $1 billion of salaries/dividends and audit hundreds of thousands of businesses. In addition, many business owners receive their first capital from friends and family. Tough new "reasonableness" tests could trigger a much higher tax rate on dividends paid to family or "connected parties" if the labour, the capital contribution or the rate of return is not deemed "reasonable."

- If a spouse is paid $70K, but CRA assesses the value of his/her labour at $40K, how should a business owner prove the value of the contribution?
- Imagine a couple that owns a restaurant for 30 years and pays themselves $50K annually in dividends. If one spouse reduces her hours worked because of aging, would she trigger a higher tax rate because of reduced labour contribution?
- What is the reasonable rate of return for a dividend from a bakery in Nova Scotia? Should we look at the ROI of similar Nova Scotian bakeries, or SMEs in the Atlantic Region, or the success rate of first-time entrepreneurs?
- Why can investors earn generous returns from public companies, but private companies require a reasonable labour or capital contribution?
- Is the government worried about discouraging investment in corporations because overly generous dividends might trigger a higher rate of taxation under new rules?

2. Tax on passive income: Currently, passive (investment) income is taxed upfront at a rate of 50.3%. This is refundable when an investor withdraws it from the business because she will pay personal tax rates. Finance is proposing to make the 50.3% tax non-refundable, and additional tax would be paid when the income is paid out to shareholders, which is why the effective rate becomes 73%.

   Almost every business in Canada (except those on the brink of bankruptcy) has passive income. Taxing business savings at 73% means there is no incentive to keep money inside the company. In fact, most owners would be better off taking it out of the company. There are very important economic reasons to encourage owners to accumulate a surplus asset cushion in the business: it helps them to make big capital investments or to weather downturns.

   - SMEs account for 70% of job creation. Why does Finance believe removing the incentive to keep money in the business won't have negative consequences for growth and job creation?
   - Why should Canada become the only country in the world to tax passive income in this manner (no country in the EU or the U.S. or Venezuela or China applies a different tax rate to passive income). Is the punishment of tax cheats worth such an odd experiment in corporate finance?
   - If an investor asked you about comparable technology businesses in the U.S. and Canada, would you feel comfortable telling her that Canada imposes a 73% tax on passive income? Would she be better off just going to the U.S.?