



**FREDERICTON
CHAMBER
OF COMMERCE**

— *The Voice of Business* —

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**Tax Planning Using Private Corporations
Department of Finance Canada
Public Consultation**

**Fredericton Chamber of Commerce
2 October 2017**



Introduction

Thank you for the opportunity to respond on behalf of our nearly 1,000 member businesses to the tax policy changes proposed in the document titled “Tax Planning Using Private Corporations” released by the Department of Finance on 18 July 2017.

We’ve been hearing from our members on a daily basis on this issue. The response is unlike anything we’ve seen at our chamber in recent memory. What’s being proposed by Minister Morneau is going to affect business of all shapes and sizes, in all industries and they are afraid for the future of their businesses and their livelihoods. In short, our members tell us that these proposed changes are their greatest concern to the viability of the businesses throughout their careers - for decades in some cases.

Our overarching concern is that the document and related communications do not demonstrate a nuanced understanding of the fundamental differences between being self-employed and being an employee- the comparisons included in the discussion document are not apples-to-apples.

Perhaps most telling is the information not included in the document. Has an economic impact study been conducted on the proposed changes? Has government evaluated the increased compliance burden and financial cost to small businesses? Has government evaluated the increased cost and administration for CRA? How will the proposed changes be managed? Some of the language is vague and subject to interpretation. For example, implementing a “reasonableness” test. Has the benefit to the Canadian taxpayer been evaluated against the potential job loss and business failures this will result in once these measures are implemented? Small businesses are the middle class, and are the employer of the middle class. Who will employ the middle class if many small businesses no longer exist? Has the potential ripple economic effect of these proposed changes been considered or evaluated?

The language chosen in the document portrays the government’s true valuation of the contributions of small business. Our members take offense to the tone of the document, implying that entrepreneurs avoid paying their “fair share” of tax due to taking advantage of “loopholes”. Characterizing the last 45 years of Canadian tax policy as loopholes is insulting to businesses that have worked within the rules in good faith to build their business, to save for retirement and sometimes just to keep their doors open.

The Minister of Finance and Prime Minister have used such misleading and targeted political rhetoric it borderlines on class warfare, recently exacerbated by the Minister of Small Business and Tourism approvingly tweeting the organization of a consortium of labour groups that support the proposals. Let us be clear: these measures do not address ‘loopholes’, they radically change existing tax policy in Canada. These “loopholes” are simply the corporate tax system that has been set up and accepted by federal governments for decades. It will take far more than a few tweaks to make these changes palatable to the small- and medium-sized businesses it will impact.



While there are many ways wealth is created, in one of its simplest forms, those prepared to assume risks are rewarded for taking the risks by way of financial gain. These risk-takers are sometimes financially rewarded. They're the ones we call successful. They're the ones who built a business from the ground up to become what it is today. Most that take that risk never see the rewards. Taking risk is so fundamental to wealth creation that it's the way most businesses begin. In the process, they often create jobs for others, benefits for society and tax revenue to support the social support systems we provide for citizens. Over the years this risk taking has become recognized as having great value for society. In order to encourage people to take the necessary risks, successive governments have built a tax structure designed to help compensate these people for the risks taken.

When businesses lose, so does the middle class. Business owners that are affected by these changes will, quite logically, take steps to protect their livelihood, their families, their retirement, their rainy day fund. This will mean fewer jobs, fewer hours for employees, less disposable income for charities and community organizations - putting further pressure on the country's social safety nets. Small business owners are the engines of our communities - these proposed changes will hurt their ability to contribute and disincentivize the next generation of entrepreneurs - not a "fair" outcome for anyone.

Beyond the political rhetoric that has damaged the government's and particularly the finance minister's credibility, members of the Fredericton Chamber of Commerce have concerns with:

1. The brief 75-day consultation period
2. Incentivizing Risk
3. Changes to income splitting practices
4. Changes to succession planning practices
5. Changes to investment income practices

Chambers of commerce and the business community-at-large agree, and have been calling for, a comprehensive review of the country's complex tax regime. However, tax professionals agree that the particular measures that the government has chosen to address will only make the tax code more complicated - increasing compliance costs for business - while not achieving the overall 'fairness' goal as stated by Minister Morneau and other members of the government.



1. Consultation Period

In aberration from other processes (Innovation Agenda, etc) the national consultation process put forth by the Department of Finance has only a 75-day period for feedback. Viewed in its best light, the government has vastly underestimated the time required for proper consultation on proposals that have the potential to impact the vast majority of Canadian employers and employees alike. Viewed skeptically, a poorly publicized process launched in the dead of summer with such a short timeframe leaves observers speculating the Government has already determined the policy outcome and has no intention of engaging in substantive dialogue. Furthermore, Minister Morneau has stated that “we will not change our minds,” in reference to the proposals. We take these as a clear signs that this is a consultation in name only.

Our tax professional members tell us that as they go through each client’s file and situation, they are finding many new and unique consequences nearly everyday. As each business owner’s tax planning is unique to their circumstances, the reforms may affect each differently. This is one of the reasons it is critical that the consultation period be extended. There have been countless examples of legislation that once enacted, was applied and interpreted differently than the drafters’ original intention. Rushing into changes with tax policy has the potential to have catastrophic consequences for the country’s small businesses and the economy generally. Businesses are thinking twice about hiring staff, they are holding off on expanding their operations, they are thinking about opening offices in other jurisdictions. Every one of these decisions has a real impact and as they accumulate will drag on the economy.

2. Incentivizing Risk

While there are many ways wealth is created, in one of its simplest forms, those prepared to assume risks are rewarded for taking the risks by way of financial gain. These risk-takers are sometimes financially rewarded. They’re the ones we call successful. They’re the ones who built a business from the ground up to become what it is today. Most that take that risk never see the rewards. Taking risk is so fundamental to wealth creation that it’s the way most businesses begin. In the process, they often create jobs for others, benefits for society and tax revenue to support the social support systems we provide for citizens. Over the years this risk taking has become recognized as having great value for society. In order to encourage people to take the necessary risks, successive governments have built a tax structure designed to help compensate these people for the risks taken.

The federal government asserts they value the contribution that small businesses and entrepreneurs make to the Canadian economy. However, this appears to be quite literally untrue given the lack of credit attributed to the risk entrepreneurs assume when starting a business as well as the financial disadvantages of owning a business. As discussed, these include employer-contributed pension plan,



Canada Pension Plan, employer-contributed health or dental benefits, maternity leave, vacation pay, sick time, and the Employment Insurance safety net.

3. Income Splitting

Described by the Department of Finance as a “loophole,” income splitting has been the legitimate basis of corporate tax planning for decades in Canada and across the world. It hardly needs to be said that this system was created by the federal government and at least tacitly approved by successive governments throughout the years. Moreover, it is a recognition that the risk assumed by entrepreneurs is borne by all members of the family unit. It is also recognition that family members make tangible contributions to the success of a business without being on the payroll. The change could have unintentional impacts on the spouse working at home, which in many cases are women. We recommend that the proposed taxation changes and potential impacts be viewed through a gender lens to ensure that women are not disproportionately impacted by any changes - which they will be as the discussion document is written. With the ambiguity of the term “reasonable contribution” introduced on page 24, spousal or other family member efforts towards the business could be devalued if the proposed changes are implemented. We fear that entrepreneurs could also end up spending more time on administration and compliance instead of growing their business and creating jobs. It is concerning that civil servants will be tasked with determining how much an individual is contributing to a business - what is their worth.

4. Succession Planning

Proposed tax reform regarding the lifetime capital gains exemption is attacking family succession planning. Under the current proposal family businesses will face double taxation if the family business is to be sold or transferred to a family member. With over 70% of businesses expected to change hands in the next decade, tax changes will severely impact the ability for succession to occur. The consequences will be that many small businesses may close when third party purchasers are not available.

As a country, we should be encouraging families to sell their businesses to the next generation - maintaining knowledge, experience - and jobs. If there are abuses with the current success regime, then they should be addressed. Surely there are other mechanisms that the government can employ that don't make it prohibitively expensive to keep the family business with the family.

5. Investment Income

The proposed legislation on investment income will significantly impact a business owners' ability to save for expansion and to weather economic downturn. Many entrepreneurs also provide capital for entrepreneurs with new ideas - this may be challenging under the new system with fewer dollars to invest in new and innovative startups. The extremely punitive proposed taxation on these funds will result in significant economic impacts on small business sustainability and growth.



There are well thought out public policy reasons for treating investment income differently. Business owners use these funds in lieu of maternity leave, sick time, vacation pay, retirement planning and many other benefits that employees receive. This income is also meant to protect the business (and jobs) during economic downturns or slow times for the business. It is what owners have to fall back on instead of EI eligibility that employees receive. The example of the fictionalized “Jonah” and “Susan” are not in remotely similar situations and serves to pit employees against entrepreneurs. An entrepreneur bears the risk, stress and rewards that comes along with owning a business. These changes could unintentionally create barriers for entrepreneurs. The same entrepreneurs that are the backbone of the Canadian economy accounting for some 1.17 million businesses in 2015, of which 97.9% were small business. It has been suggested that as an alternative, business owners could use RRSPs or a tax-free savings account in lieu of their current planning practices. This would only be feasible in limited circumstances as those vehicles do not offer the flexibility needed to effectively manage the finances of a small business.

Conclusion

A person’s tax burden should be considered on a lifetime basis, considering both personal and corporate taxes where applicable. Tax professionals tell us that under the current system their clients will pay tax equal to an employee and any difference is simply about timing. Business owners that have incorporated do not have the same tax situation as an employee. Nor do they have the same safety advantages as detailed below. The current attempt by the government to make their situations ‘fair’ misses the point - what the discussion document tries to do is make the situations exactly the same, when they clearly are not. Trying to square this circle is only leading to unnecessarily divisiveness and yes, unfairness.