COALITION FOR SMALL BUSINESS TAX FAIRNESS

September 26, 2017

The Honourable Bill Morneau
Minister of Finance
Finance Canada
90 Elgin
Ottawa, Ontario K1A 0G5

Subject: Coalition for Small Business Tax Fairness letter on proposed tax proposals

Dear Minister Morneau,

Since we last wrote, the **Coalition for Small Business Tax Fairness** has doubled in size and now represents more than 70 business associations. Together, our organizations represent hundreds of thousands of independent businesses, professionals and taxpayers across all sectors of the economy and all regions of the country that employ millions of Canadians. Minister, we are renewing our call for your government to set aside these changes in favour of a comprehensive review of Canadian tax policy.

We have been following your government's public comments on the proposed changes closely. We are alarmed by the significant gap between the government's statements on the expected effects of the proposals and the analyses by Canadian tax practitioners. This requires immediate clarification.

Your government has stated that it is concerned with the growing number of Canadian Controlled Private Corporations (CCPCs) and the goal of the tax changes is to ensure business owners pay the same rates as other Canadians in pursuit of tax fairness. You have also suggested that your proposals would not affect business owners with incomes under $150,000.

These statements are at odds with all the analyses conducted by tax professionals in several important ways.

1. Business owners at all levels of income will be potentially affected by at least one of the three measures in this package of changes, including those earning well below $150,000.
2. Many – if not most – business owners will face a higher overall tax burden in the future if these proposals proceed.
3. Business owners will pay higher rates of taxation than other Canadians at the same income level as a result of some of the proposed changes.

Impacts of changes on income sprinkling

Changes to income sprinkling have the potential to affect <u>all</u> incorporated taxpayers that have family members as shareholders who contribute to the business, regardless of income. In fact, this could remove the benefit of sharing business income from taxpayers earning $50,000, not just those above $150,000.

The additional paperwork associated with the “reasonableness test” will also bring added costs and complexity for many business owners who will struggle to cope with compliance requirements due to the ambiguity created by the new rules and fear of being unfairly penalized by CRA. We worry that your government is not fully aware of many formal and informal ways family members in businesses play critical roles in contributing to the success of the business and believe there will be many unintended consequences of your proposed changes on all business owners, including those in the middle class.

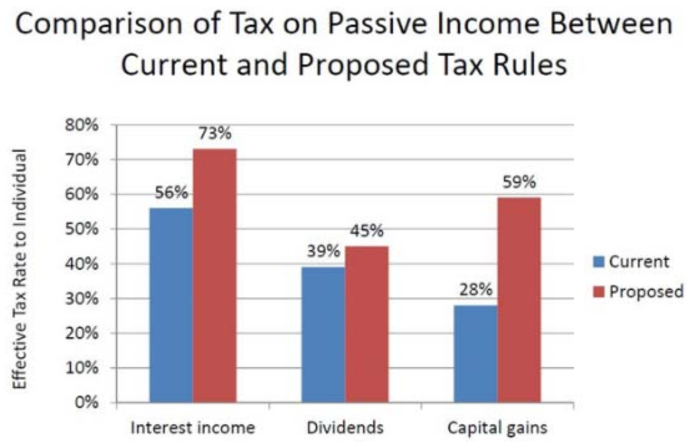
Impacts of changes to passive investment rules

First, we wish to challenge the assumption that the deferral of the personal level of tax on corporate business earning is bad tax policy. There are a number of reasons why a business owner would choose to, or be required to, retain business earnings in the corporation. We offer the following observations:

- Under the current corporate tax regime in almost all provinces, business earnings inside a corporation are actually under-integrated. This means the business owner will pay more tax on business income earned inside a corporation (and distributed as a dividend to the owner) as compared to the same earnings in an individual’s hands.
- Many business that are financed have debt arrangements that require a fixed amount of retained earnings to be left in the corporation, or limit the amount that can be distributed to the shareholders.
- Many businesses incur losses in their start up years that the shareholder cannot use to offset personal income.
- Successful businesses (particularly in the high-tech sector) use retained profits in the corporation to invest in other start-ups (angel funding). Such investments carry a high level of risk and punitive levels of taxation will reduce an important source of financing for new firms.

While we recognize you have not put forward draft legislation on passive income rules, tax practitioners agree that the current proposals could result in a combined corporate and personal tax burden for an Ontario business owner of as much as 73% on corporately-earned investment income and 59% on corporately-realized capital gains (assuming a business owner is paying the highest marginal rate of taxation) (see figure on next page). This is far more than what an employee with a similar level of investment income would pay. Regardless of the level of income however, the consensus is that the proposed tax changes would result in higher combined corporate and personal taxes for business owners across the board, and would therefore no longer be aligned with the key tax principle of integration.

Furthermore, your government seems to be asserting that middle-class business owners could use other retirement vehicles such as RRSPs and TFSAs if they want to save for retirement. While many do use these vehicles, a large number of business owners require the flexibility of retaining passive investments in the business to ensure they can quickly access money for the business itself since current RRSP rules do not allow for business reinvestment. While government may reap a short-term benefit by encouraging business owners to withdraw any money available for investments from the business, this will have long-term negative consequences as businesses are left cash strapped in challenging times or when an opportunity for growth or expansion occurs.



Impacts of changes to capital gains rules and intergenerational transfers

It is our understanding based on analysis done by many tax professionals in Canada, that the tax changes on capital gains will have a material impact on intergenerational transfers of business, again regardless of income level. There is fear that long-standing family businesses may be forced to sell the business to non-family members in order to decrease the ultimate tax bill on transition, whether on the retirement of the current business owner or on death.

For example, the tax bill for an intergenerational transfer that results from the death of the owner will effectively increase by as much as 70% from what it was before July 18, 2017. Depending on province or territory, the former capital gains rate on death of about 24-27% will increase to an effective dividend rate between 40-46%. And this increased tax cost can apply as a result of a death that occurred before July 18, 2017 contradicting the statement that none of the proposals are retroactive.

Disproportionate Impacts on Women Entrepreneurs

The proposed tax changes may limit women from benefitting from entrepreneurship. As two-thirds of Canadian incorporated businesses are majority owned by men, the restrictions on sharing income with a spouse are likely to remove a disproportionately higher number of women from benefiting from business ownership. In addition, while entrepreneurs do have optional access to limited Employment Insurance benefits during maternity or parental leaves, female led businesses can currently use passive income investments to ensure their business remains open during a maternity leave, protecting the income of both the business owner and the employees. We believe strongly that the proposed changes on income sprinkling and passive income would fail a gender-based analysis.

Minister, the Coalition urges you to review carefully the dozens of analyses of your proposed changes by tax professionals across the country. While we are aware of a few academic papers supporting your changes, tax practitioners are united in the view that these changes have the potential to affect business taxpayers at all levels of income and increase their rates of taxation to levels higher than that of other taxpayers. To assist your efforts, we have listed five reports supporting our concerns and would be pleased to provide others to your staff.

Report 1: STEP Examples (available in PDF only and attached to this letter)
Report 2: Moodys Gartner Tax Law - Proposed Tax Changes: What Do They Mean To You?
Report 3: Deloitte - Tax Alert - Capital gains implications
Report 4: Yale & Partners submission to Finance Canada
Report 5: Goldberg, Killoran and Goodis – Is a 93% tax rate fair to Canadian small business owners?

Conclusion and Recommendations

We would like to reiterate our offer that should there be worrisome abuses of the current tax system, we stand ready to work with the federal government to pursue ways to tighten the rules. The current proposals are not the solution and are creating unnecessary uncertainty for business owners.

While we appreciate your public statements indicating an openness to "tweaking" the proposals, we feel the significance of these proposals requires far more than a few tweaks. We make the following recommendations:

- **Take these proposals off the table.**
- **Launch meaningful consultations with the business community to address any shortcomings in tax policy without unfairly targeting independent businesses.**
- **Consider a comprehensive review of the Canadian tax system with a view toward fairness and simplification for all taxpayers, which was recommended by the Standing Committee on Finance in their report dated December 2016.**

Please do not hesitate to reach out to any of the undersigned groups and sectoral associations should you have any questions or comments about the contents of this letter. We remain committed to working with you.

Sincerely,

Greg Pollock
President and CEO, Advocis
The Financial Advisor
Association of Canada

13,000 members

Leah Olson
President
Agricultural Manufacturers
of Canada

Andy Brooks
CEO, Alberta Roadbuilders
& Heavy Construction
Association

1,000 members

Luc Bélanger
CEO
Association des
professionnels de la
construction et de
l'habitation du Québec

John D. Gamble, CET, P.Eng.
President & CEO
Association of Consulting Engineering Companies

Alan Rowell, MFA, DFA-Tax Services Specialist
Director, Association of Tax and Accounting Professionals

187 members

Caroline De Guire, M.Sc. Écon.
CEO, Association québécoise des informaticiennes et informaticiens indépendants

1,500 members

Jean Thiffault
President
Association québecoise des pharmaciens propriétaires

Robert Laing
CEO
British Columbia Real Estate Association

A.Z.

John Reid
CEO, Canadian Advanced Technology Alliance

Liz Robertson
Executive Director
Canadian Association of Farm Advisors

400 members

Mary Blair
Managing Director
Canadian Association of Management Consultants

2,500 members

Dr. Michael Dennis, President
Canadian Association of Optometrists

4,800 members

Dr. Emil Lee, President
Canadian Association of Radiologists

2,182 members

Kerry Simmons, Q.C.
President,
Canadian Bar Association

36,000 members

Terry Kremeniuk
Executive Director
Canadian Bison Association

550 members

Dan Darling, President
Canadian Cattlemen's Association

60,000 members

Perrin Beatty
President and Chief Executive Officer
Canadian Chamber of Commerce

200,000 members

Michael Atkinson
President
Canadian Construction Association

20,000 members

Dr. Larry Levin
President
Canadian Dental Association

Ron Bonnett
President
Canadian Federation of Agriculture

200,000 members

Dan Kelly
President and CEO
Canadian Federation of Independent Business

109,000 members

Lorraine McLachlan
President & Chief Executive Officer, Canadian Franchise Association

750 Corporate members representing 40,000+ franchised outlets

Kevin Lee, Chief Executive Officer, Canadian Home Builders' Association

8,500 members

Alvin Keenan,
President
Canadian Horticultural Council

27,500 members

Keith Costello, BADM, MBA-Strategy
President & Chief Executive Officer
Canadian Institute of Financial Planners

8,000 members

Ralph Suppa, CAE,
President & General Manager
Canadian Institute of Plumbing and Heating

260 members

Edward Whalen, P.Eng.
President & CEO
Canadian Institute of Steel Construction

Christopher White
President & CEO
Canadian Meat Council – conseil des viandes du Canada

CMC
CANADIAN MEAT COUNCIL
CONSEIL DES VIANDES DU CANADA

52 Regular Members and over 92 Associate Members

Dr. Laurent Marcoux
President
Canadian Medical Association

ASSOCIATION MÉDICALE CANADIENNE CANADIAN MEDICAL ASSOCIATION 1867–2017 150

85,943 members

Samantha Gale
Executive Director
Canadian Mortgage Brokers Association

CMBA
CANADIAN MORTGAGE BROKERS ASSOCIATION

5,000 members

Perry Eisenschmid
Chief Executive Officer
Canadian Pharmacists Association

CANADIAN PHARMACISTS ASSOCIATION ASSOCIATION DES PHARMACIENS DU CANADA

John Ross
Executive Director
Canadian Pork Council

Canadian Pork Council
Conseil canadien du porc

7,000 producers

Ron Lemaire
President
Canadian Produce Marketing Association

CPMA ACDFL CANADIAN PRODUCE MARKETING ASSOCIATION ASSOCIATION CANADIENNE DE LA DISTRIBUTION DE FRUITS ET LÉGUMES

Gary Simonsen
Chief Executive Officer
Canadian Real Estate Association

CREA
THE CANADIAN REAL ESTATE ASSOCIATION

122,000 Realtors

Bob Brunet, CAE, BComm
Executive Director
Canadian Roofing Contractors' Association

CANADIAN ROOFING crca CONTRACTORS' ASSOCIATION

400 members

Aaron Wudrick, Federal Director
Canadian Taxpayers Federation

Canadian Taxpayers FEDERATION

123,000 supporters

Dr. Troye McPherson
President
Canadian Veterinary Medical Association

CANADIAN VETERINARY MEDICAL ASSOCIATION
L'ASSOCIATION CANADIENNE DES MÉDECINS VÉTÉRINAIRES
CVMA ACMV

6,665 members

Kevin Wong, CAE, MBA
Executive Director
Canadian Water Quality Coalition

CWQA
CANADIAN WATER QUALITY ASSOCIATION

208 members

Sean Hu
Executive Director
Chinese Business Chamber of Canada

中华商会

1,300 members

James Swan, MD, FRCPC
Coalition of Ontario Doctors

2,450 members

Guy Legault
President
Conference for Advanced Life Underwriting

670 members

Léopold Turgeon
Président-directeur général
Conseil québecois du commerce de détail

5,800 members

Bill Brushett
President and CEO
Family Enterprise Xchange

Fédération des chambres de commerce du Québec

139 Chambers and 50,000 businesses

Sandra Kegie
Executive Director
Federation of Mutual Fund Dealers

Jaye Hooper, Chair of the Federation of Ontario Law Associations

8,500 members

Mark Brock
Chair
Grain Farmers of Ontario

28,000 members

Jeff Nielsen
President
Grain Growers of Canada

50,000 members

Iain J.S. Black
President and CEO
Greater Vancouver Board of Trade

5,200 members

Warren Heeley
President
Heating, Refrigeration and Air Conditioning Institute of Canada

Nancy Allan
Executive Director
Independent Financial Brokers of Canada

3,500 members

Jeff Wachman
President
Institute of Advanced
Financial Planners

Richard McKeagan, Chief
Executive Officer
Mechanical Contractors
Association of Canada

900 members

Terrance Oakey
President
Merit Canada

3500 members

Dr. Cora Pettipas
President
National Exempt Market
Association

400 members

Mark Prieditis, MD, FRCPC
President
Ontario Association of
Radiologists

1,400 members

Keith Currie
President
Ontario Federation of
Agriculture

37,000 members

Dr. Shawn Whatley,
President
Ontario Medical Association

43,493 members

Ettore Cardarelli
President
Ontario Real Estate
Association

Tony Elenis
President & CEO
Ontario Restaurant Hotel
and Motel Association

11,000 members

Doug Bedard, Chair

Georgina Blanas, Executive
Director
Private Capital Markets
Association of Canada

Membership 500

Sean Reid
Vice President
Progressive Contractors
Association of Canada

180 members

Grace Sammut
Executive Director
Resorts of Ontario

Shanna Munro
President and CEO
Restaurants Canada

30,000 members

Diane J. Brisebois
President & CEO
Retail Council of Canada

45,000 members

Shane Jahnke
Saskatchewan Stock Growers Association

600 members

Levi Wood
President, Western Canadian Wheat Growers Association

John Schmeiser
CEO
Western Equipment Dealers Association

800 members

c.c. All Members of Parliament