SAINT JOHN REGION
THE CHAMBER
CHAMPIONS FOR BUSINESS

Sept. 28, 2017

TO: Members of Parliament Wayne Long, Alaina Lockart, Karen Ludwig
FROM: The Saint John Region Chamber of Commerce

RE: Small Business Tax Changes

The tax changes the government has proposed are the most significant tax changes we have seen in 45 years. They have the potential to alter our current tax system in fundamental ways. There is great concern over the negative impact these changes could have on owner-managed businesses across Canada. There are also serious concerns over the impact that proposed rule changes will have on retirement plans currently in place for thousands of Canadian business owners.

What we are asking the government to do:

• Rethink its proposed tax changes to ensure that no harm is done to small businesses across Canada.
• 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.

General

• The material provided by the government and the 75-day consultation period it has allocated during the dog-days of summer are inadequate to deal with the technical and substantive issues involved.
• The government indicates that its proposed tax rules are not yet in force and that changes could still be made to draft legislation following the end of the consultation period. However, it has long been understood by tax practitioners that tax filings should be based on draft legislation as though it has been passed into law.
• We are seriously concerned that while the government insists its tax changes are not intended to harm small business, the accounting community across Canada advises otherwise.
• The 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. It has also suggested that the 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 potentially be 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.

• The government keeps referring to its intention to shut down "tax loopholes" for the wealthiest Canadians. These are not tax loopholes. Tax planning occurs on the basis of current tax legislation and case law. Moreover, the structures that the government is proposing to change (income splitting, passive income for example) are not limited to the wealthiest taxpayers but are used by middle class Canadian business owners.
• Those affected by these tax changes will lose important incentives to take the risk they take as business owners. Many middle-class business owners are affected. They are the entrepreneurs who put mortgages on their homes to finance their business and have other family members sign guarantees as collateral security for business loans. These are the business owners who take risks to create jobs for other Canadians.
• Much of the proposed legislation is based on equating business owners with employees. Nothing could be further from the truth. Small business owners take far more risk, more responsibility in meeting payroll, and invest far more time and effort in their businesses than employees, and do so without the same level of benefits or pension entitlement afforded to employees.
• Many small business owners have indicated that if these rules pass in their current form, they will shut down their business, seek full time employment positions, or move their business out of Canada.

Income splitting
• The 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. As a result, there will be many unintended consequences of the proposed changes on all business owners, including those in the middle class.
• 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.
• Changes to income sprinkling have the potential to affect all 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.
• With a July 18, 2017 effective date, business owners will have less than six months to plan for transition. The government should extend the period before its new rules apply.
• How will the government ever manage to legislate reasonableness of labour and capital contributions? This will only result in more audits, disputes, and conflicts between taxpayers and CRA. 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.
• Many business owners have not established RESP accounts for their children but have relied on income splitting to help them fund post-secondary education. The government should consider the impact that disallowing income splitting for taxpayers between the ages of 18 and 24 will have on the

ability of young people to finance their education. A de minimis amount for dividends to young adults in this age group should be considered. The amount would not be subject to a reasonableness test if used for defined acceptable purposes like education, retirement savings, etc.

• Dividends paid to spouses to fund RRSP contributions should likewise not be subject to a reasonableness test.

Impacts of changes to capital gains rules and intergenerational transfers

• The tax changes on capital gains will have a material impact on intergenerational transfers of business, 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 which contradicts the statement that none of the proposals are retroactive.

Taxation of passive income

• The proposed tax rules reverse the government's long-standing tradition of incenting entrepreneurship through passive income within small business corporations.

• The deferral of the personal level of tax on corporate business income is not a bad tax policy. There are several reasons why a business owner would choose to, or be required to, retain business earnings in the corporation:

1. 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.
2. Many businesses 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.
3. Many businesses incur losses in their start up years that the shareholder cannot use to offset personal income.
4. 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.

• 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). This is far more than what an employee with a similar level of investment income would pay. 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.

• Refundable tax is an asset of many companies and removing it from the mix going forward would significantly reduce the value of small businesses.

• If business owners need to withdraw more money from their business to maximize their contributions in RRSPs or TFSAs, they will be leaving less income in their business, effectively reducing the amount of savings that would be available to sustain their business over a period of cash flow difficulties or to save in order to re-invest in future business growth. The accumulation of funds is necessary for business owners who do not get access to EI benefits and who need rainy day funds to help with the cyclical nature of their business.

• 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.

• Business owners who pass away owning private companies have the potential for double taxation.

• The notion of grandfathering the assets owned at the transition date will be extremely difficult to manage.

In conclusion, the new rules are extremely complex – small business owners and tax professionals have difficulty in understanding how they would apply. Much more work and assessment needs to be done on these proposals, which as currently framed will have far-reaching negative impacts on business sustainability and investment, as well as on the principle of integration, a long-standing feature of the tax system.

We thank you for your consideration and look forward to a resolution to the situation, one which is acceptable to the millions of Canadian business.

Best regards,

Claire Ryan – Chair, The Saint John Region Chamber of Commerce
David Duplisea – CEO, The Saint John Region Chamber of Commerce