

COALITION FOR SMALL BUSINESS TAX FAIRNESS

November 20, 2017

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

Subject: Coalition for Small Business Tax Fairness feedback on revised tax proposals

Dear Minister Morneau,

Since we last wrote, the **Coalition for Small Business Tax Fairness** has further grown in size and now represents close to 80 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. We are writing today to provide feedback on revisions to the proposed tax changes announced during Small Business Week.

Our Coalition welcomes the federal government's decision to reinstate its promise to reduce the small business corporate tax rate from 10.5% to 9% by 2019. This decision will pump hundreds of millions of dollars back into the small business community, helping them create more jobs and grow the economy.

As for the amendments to the July tax proposals, we are encouraged to see some of the major concerns addressed in full or in part. We are particularly pleased that the government has listened to the concerns of business owners by stepping back from the measures relating to the conversion of income into capital gains. These rules would have made it more costly for small business owners — including farmers and fishers — to sell or transfer their business to their children.

We are also pleased that your government has begun to recognize the important role passive investments can play in the life of a business and its owner(s).

While we thank you for making progress on the items noted above, we remain very concerned by the remaining proposals that appear to be moving ahead. We find it quite concerning that the Department of Finance was able to parse through 21,000 written submissions in just under two weeks. We question whether the largest set of tax changes in over 40 years was given its due diligence in such a short period of time. In fact, tax practitioners are still reviewing the revised announcements from your government and are of the view that more details are urgently needed.

While we continue to review the revised proposals, we raise the following concerns and recommendations relating to the income sprinkling and passive investment proposals.

Income Sprinkling Rules

The rules that will penalize business owners for paying dividends and other forms of income to adult family members remain a significant concern. The proposed changes do not reflect the many formal and informal ways family members participate in the business, especially when it comes to the participation of spouses. However, the government says it will still move ahead with requiring a "reasonableness test" for family members to ensure that they are making a "meaningful contribution" to the business before allowing them to share income with that family member.

While it was implied that the process will be simplified and more targeted, no further details have been provided and time is quickly running out as the changes are set to take effect January 1, 2018. **We urge you to provide these details as soon as possible and allow time for stakeholder input to help minimize any unintended consequences.** Given the key role spouses (including common law partners) often have in a business that cannot always be clearly quantified, we would also **recommend that the federal government consider at a minimum an exemption for spouses from the new sprinkling rules. In addition, the Coalition recommends that the federal government postpone the implementation of the changes until, at the very least, January 1, 2019.** As the burden of proof and compliance remains on the business owner, the delay would help ensure that the business community is fully aware and provided with sufficient time to implement required fixes to existing business structures.

Passive Investments

As noted, we are pleased that the federal government made changes to begin to recognize the importance of permitting some passive investment (and resulting income), however, we believe the amendments will be inadequate for many— particularly for those businesses saving for larger investments, innovations or expansion. While the \$50,000 annual threshold will be helpful for small businesses that want to remain small, it will be insufficient for those who are saving to grow and create more business opportunities.

Canada already has a dearth of medium-sized businesses and the \$50,000 annual income threshold may be insufficient to help businesses looking to get to the next level. In addition, an amount of \$1 million will provide an owner with an annual annuity of between \$34,000 and \$54,000. After a lifetime of taking risks and building a business, this would amount to less than a teacher's pension in most provinces.

In addition, we believe most small businesses will continue to be saddled with additional complexity and compliance costs despite the \$50,000 allowance for passive investment income. For example, the acquisition of a passive real estate investment for \$100,000 could result in a significant one-time gain on a future sale that would put the business over the \$50,000 annual limit. Alternatively, over an extended period of time, even nominal growth in passive investments could result in passive income exceeding \$50,000 per year on recurring basis. We therefore think that the government's statement that the \$50,000 allowance will result in a vast majority of small businesses not being impacted is incorrect.

We therefore recommend that the government drop the passive investment rules until a full economic impact assessment has been completed and an approach has been developed that will ensure there are no unintended consequences.

We understand that proposed legislation on passive investments is to be brought forward in federal budget 2018 and we want to ensure we take the time to get this right. The Coalition is seeking more clarity about how this change will be implemented, including whether the threshold will be indexed to inflation and whether any unused income can be carried forward over time, similar to TFSA/RRSP rules.

Intergenerational Transfers

We are pleased your government has expressed an openness to making it easier and less costly to transfer a business to the next generation. Two private members' bills — from NDP MP Guy Caron (Bill C-274) and Liberal MP Emmanuel Dubourg (Bill C-691) — proposed amendments to a section of the Income Tax Act which currently makes it easier to sell a family business to a third party than to a family member. In Canada, when an individual sells their business to a family member, the difference between the sale price and the price originally paid is considered a dividend. If the individual sells the business to an unrelated person, it is considered a capital gain. This difference in the Income Tax Act discourages the transfer of a business to a family member because the transaction does not benefit from the lifetime capital gains exemption and is, therefore, more heavily taxed. Both these bills try to address this flaw in the tax system.

As previously stated, **we stand ready to work with the government on finding solutions to ensure that intergenerational transfers of small businesses are easier and less costly, while, at the same time, maintaining the integrity of the tax system.**

Conclusion and Recommendations

Given the complexity of these proposals, more analysis and consultation is needed to fully understand the effect on the small business community. We look forward to working with the government to continue to find solutions that do not negatively affect the small business community's ability to grow and prosper. We therefore **recommend:**

1. Immediately undertake an economic impact assessment of the package of proposed changes and delay implementing any tax changes until this assessment is complete.
2. **On income sprinkling:**
 - Postpone the implementation of the changes until, at the very least, January 1, 2019.
 - Consider, at a minimum, a full exemption for spousal income and dividends from the new income sprinkling rules.
3. **On passive investment:**
 - Do not proceed with the proposed passive investment rules.
4. Look at ways to make **intergenerational transfers** easier and less costly for business owners.
 - Implement changes to make intergenerational transfers tax neutral compared to arm's length sales.

5. Undertake a comprehensive review of Canada's income tax system.

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
The Financial Advisor
Association of Canada
(Advocis)



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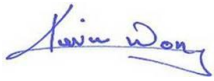


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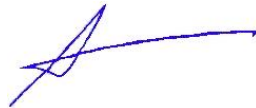
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cc: Mr. Alexandre Boulerice, NDP Member of Parliament for Rosemont-La Petite Patrie, Finance Critic
Senator Percy Mockler, Chair of the Senate Committee on National Finance
The Honourable Pierre Poilievre, Conservative Member of Parliament for Carleton, Shadow Minister of
Finance and National Capital Commission
The Honourable Wayne Easter, Liberal Member of Parliament for Malpeque, Chair of the Standing
Committee on Finance
The Right Honourable Justin Trudeau, Prime Minister of Canada