GREATER VANCOUVER
BOARD OF TRADE

Greater Vancouver Board of Trade
World Trade Centre
400 – 999 Canada Place
Vancouver, B.C. Canada V6C 3E1
T. 604-681-2111 F. 604-681-0437
E. contactus@boardoftrade.com
boardoftrade.com

President and CEO
Iain J.S. Black, ICD.D

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DELIVERED VIA E-MAIL [fin.consultation.fin@canada.ca]

The Honourable Bill Morneau
Minister of Finance
Finance Canada
140 O'Connor Street
Ottawa, Ontario K1A 0G5

Dear Minister,

Re: Tax Planning Using Private Corporations

On behalf of The Greater Vancouver Board of Trade (the "GVBOT"), we respectfully submit this letter in response to the Government of Canada's call for consultation regarding the proposed changes to Canadian Controlled Private Corporations taxation.

Our commentary reflects the interests and priorities of the GVBOT Directors, and our over 5,000 Members from across the Greater Vancouver region. Of these Members, over 80% identify as small or medium-sized enterprises (SMEs). SMEs are the backbone of our economy accounting for 98% of businesses and 55% of private-sector employment in British Columbia, and 70% of private-sector employment in all of Canada.

The GVBOT supports the Government's agenda of building a stronger tax-code which grows our economy. However, the GVBOT believes the measures proposed by Government target legitimate, and necessary, tax planning structures that have been utilized by small businesses for decades. These tax planning structures provide necessary incentives for healthy and vibrant business cultivation, encompassing the fundamental tools that all businesses utilize to plan for the risks they undertake. GVBOT advises the Government to "Hit the Pause Button" and take a more holistic approach in developing a comprehensive set of tax reforms to strengthen Canada's small business community.

In this letter, we outline the concerns of our Membership, some of which were voiced at a special, Member-only meeting on Friday, September 15th, 2017 on 'Proposed Tax Changes: Protecting Small Business'.

Over the past month, we provided our Members with an online platform to help them contact their MPs regarding these changes. With over 25,000 emails sent so far, the response from our Membership has been unprecedented in our organization's 130-year history.

Our commentary in this letter is divided into four key areas of focus: i) the distinction between business owners and employees, ii) costs of compliance and uncertainty, iii) the necessity of business flexibility, and iv) the disproportionate effects on women. This letter concludes with recommendations.

Section 1: Distinction between Business owners and Employees

We commend the Government for its mandate to support small businesses and create a strong middle class. However, the proposed tax changes will have significant, unintended effects on all SMEs, particularly middle-class, family businesses.

1.1. Distinction between Business Owners and Employees

The proposed legislation is based on an over-simplified comparison between business owners and employees. Businesses should not be subject to similar conditions as their employees, as they operate under different circumstances. Small business owners undertake significant risk when investing substantial amounts of time and capital into their businesses. These are risks not undertaken by employees, and the tax code should reflect these important differences. Young businesses particularly depend on surplus profits for business growth. Changes to the tax system that subject them to greater financial and regulatory burdens could severely impact their chances of success, and ability to provide employment.

1.2. Unaccounted Risk on Family Units

An entire family unit often shares in the risk of a family SME. Prescribing a "reasonable" amount that a family member may attain for their contributions is complex and may not be quantifiable in monetary units. This measure does not account for the repercussions of success and failure of the business, which is shared by the entire family unit. From stay-at-home spouses to financial and lifestyle sacrifices, family members contribute to businesses formulation and growth in many ways which fall outside of the "reasonableness" test proposed by the Government.

1.3. Strengthen Existing Legislation

Each Provincial "Business Corporations Act" includes the concept of "personal services business." This is intended to restrict an individual's ability to incorporate for the purpose of sheltering employment income at the corporate income tax rate. The "kiddie tax" also restricts the ability to shift passive income to children to take advantage of lower tax rates. Adding to the existing legislation increases the complexity, uncertainty, and the regulatory burden on small businesses. Enforcing and revising the rules that currently exist will provide a more adequate response to preventing people from using tax “loopholes” through corporations.

<u>Section 2: Costs of Compliance and Uncertainty</u>

Landscape changes, such as these tax proposals, require a complete overhaul of current business procedures and new forms of tracking, which will all inevitably lead to greater uncertainty. Many businesses owners will be required to completely restructure their personal and corporate finances, at a significant cost. The changes proposed are complex and will add unnecessary compliance fatigue.

2.1. The Costs of Compliance

Compliance costs weigh heavily on both taxpayers and business owners with disproportionate impacts on smaller businesses. CRA auditors and the government will need to make resources available to assist businesses in the transition to the new tax system. Often much of the time exerted to comply with tax codes in small businesses will be allotted after the hours of business operation, increasing unnecessary stress, and draining resources that would be otherwise used in economically productive activities. The opportunity cost of which could be time spent expanding their business and growing the economy.

2.2. Uncertainty of Legislation

The proposed legislation regarding assessing reasonability, particularly assessing past labour and capital contributions, introduces a significant degree of uncertainty. Uncertainty will freeze business activities until owners can be sure of future projections, and how these changes will impact their tax structures. This will stifle entrepreneurship, innovation, and growth. Three activities which are necessary for creating a diverse and vibrant economy.

2.3. The Consequence of Retroactive Legislation

A healthy and sustainable economy requires transparency and certainty. Retroactive legislation is a clear violation of this and deters the entrepreneurial spirit, making business owners risk averse. More specifically, broadly worded anti-avoidance provisions that can apply to *bona fide* business transactions undertaken prior to the announcement of the proposed legislation should be re-worded and narrowed in scope to target those taxpayers, who are abusing the intent and spirit of the tax legislation. We ask for a revision of the scope of the proposed legislation to hone-in on bad-actors.

<u>Section 3: Business Flexibility and Innovation</u>

The GVBOT commends the Government for placing innovation front and centre in its federal agenda through various initiatives, particularly the Innovation Superclusters Program. The rewards of strengthening our technology ecosystems will allow Canada to grow prosperously and sustainably. However, by suppressing innovation and entrepreneurship, the GVBOT believes the proposed tax changes are inconsistency with the Government's own agenda. Businesses in B.C. must already plan for the cumulative impacts of higher minimum wages and carbon taxes, increased personal income taxes and uncertainty due to North-American Free Trade Agreement (NAFTA) negotiations. The cumulative affects these changes at once will severely stunt business growth and innovation, and hamper Canada's overall competitiveness.

3.1. Hedge Against Risk

Passive income is retained in a business to hedge against risk, plan for further growth and accumulate capital that can be used to expand the business and/or plan for retirement. The GVBOT is concerned that the Government is dictating where businesses should hold their wealth and incentivizing owners to take capital out of the business despite being crucial to small business survival. These practices which being targeted by the Government are crucial to help businesses plan for the natural business cycle and survive during lean years. Eliminating the incentive to save surplus revenue in a business could result in severe unintended ramifications for businesses and their owners alike.

3.2. Plan for Retirement

Currently, shareholders of corporations are able to use existing excess capital to earn passive investment income to provide a stream of income for retirement. Legislation that will impact existing corporate structures and limit after-tax income available for retirement, may essentially deny small business owners and their spouses the ability to retire when anticipated or afford the retirement they had planned for.

3.3. Retain Flexible Business Practices

We acknowledge that the Government encourages business owners to use registered plans such as TFSAs and RRSPs for business profits in lieu of passive investments in corporations. TSFAs and RRSPs are important tools to save for retirement. However, small businesses often operate within tight margins and require the flexibility to save and move capital around, to take, or hedge against risk or to expand their business. Many registered plans limit the movement of accumulated capital, and therefore reduce flexibility and functionality of passive investment capital that entrepreneurs require to succeed and expand.

3.4. Deterring Innovation

The Government has made clear their ambition to incentivise innovation, not deter it. The GVBOT believes the proposed changes are likely to reduce fundamental start-up funding. Business owners often make passive investments in start-ups and discouraging these investments by means of a higher tax rate will starve start-ups of the funding they require to get off the ground. We are particularly concerned about how the proposed changes will stunt the investment in — and expansion of — the tech industry, a key driver of economic growth and innovation in Canada, particularly B.C. The Greater Vancouver region already fares poorly in attracting venture capital and seed funding for its rapidly growing tech start-up sector. As found in the Greater Vancouver Economic Scorecard 2016, for every US$1 million of GDP, the region receives 0.003% in venture capital, earning it a 'C' grade relative to its competitors. Montreal also earned a C grade, while Toronto, Calgary and Halifax earned 'D' grades. Canadian companies have long struggled with attracting necessary capital investment, and these tax changes stand to exacerbate the issue.

Section 4: Disproportionate affects on woman

The GVBOT commends the Federal Government's constant support and mandate to advance women in all areas of society and business. The GVBOT believes however, that the proposed changes to income sprinkling and passive income fail a gender-based analysis and disproportionately affect women.

4.1. Income Splitting Disproportionately Affects Women

Only one third of Canadian incorporated businesses are majority owned by women. The proposed legislation will likely disproportionately affect women from utilizing spousal income sprinkling and therefore benefiting from business ownership, despite being equal partners in all other aspects of their lives and finances. As outlined previously, all spouses share in the risk of businesses formulation and growth, and these contributions are not always quantifiable in a reasonableness test.

4.2. Women Pay for their own Maternity Leave

Female entrepreneurs often use passive income investments to fund their maternity leave. This includes ensuring their businesses remain functioning, protecting the income of all employees, and allowing themselves to earn income while they take leave. This is a fundamental tax tool which allows women equal and fair compensation for owning their own business. The proposed tax changes will severely limit this practice.

Recommendations

The GVBOT believes that the Government must 'Hit the Pause Button' and take a comprehensive approach to the tax reform, including a more inclusive consultation with stakeholders.

1. "Hit The Pause Button"

Pause. Extend the consultation period. Include more consultations with the business community.

Considering the broad-based implications of the proposed changes we believe the consultation period is far too short. We ask the government to launch discussions with the business community that address the limitations in the proposed policies. Allow time for businesses to fully comprehend the implications to their livelihoods of the proposed changes and create a more inclusive forum for meaningful discussion.

A pre-written legislation proposed prior to a consultation process hinders policy change that will ultimately benefit the Canadian economy as a whole. In addition, the way the proposed changes have been communicated villainizes businesses for their current tax practices, although such activity has been the norm for decades. The Government has worryingly termed these legitimate practices as "loopholes." Some of these policies were introduced by Government as far back as 1972, after an extensive review by the 1966 Carter Commission. Incorporated businesses are not taking advantage of loopholes, but planning their affairs in a tax-efficient manner that respect the existing policies introduced by Government. Again, we recommend an extension of the consultation period to address the concerns of businesses.

2. Review, Strengthen and Simplify Current Legislation

The GVBOT recommends the Government consider a comprehensive review of the Canadian tax system to help further the Government's mandate of creating a stronger Canadian economy. Simplifying legislation will also help businesses comply without increased burden and risks.

The Greater Vancouver Board of Trade has worked on behalf of our region's business community to promote prosperity through commerce, trade, and free enterprise for 130 years. Our mission is to work in the enlightened interest of our Members to promote, enhance and facilitate the development of the region as a Pacific centre for trade, commerce, and travel. The Board strives to enable and empower its Members to succeed, grow and prosper in the global economy.

Sincerely,

Greater Vancouver Board of Trade, per;

Iain J.S. Black ICD.D
President and CEO

CC:
[Members of Parliament, Greater Vancouver Region]