



HOUSE OF COMMONS
CANADA

**STUDY ON SMALL BUSINESS
TAX MEASURES**

REPORT OF THE STANDING COMMITTEE ON FINANCE

**Massimo Pacetti, M.P.
Chair**

October 2004

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THE STANDING COMMITTEE ON FINANCE

has the honour to present its

FIRST REPORT

In accordance with its mandate under Standing Order 108(2), your Committee has studied the question on Small Business Tax Measures and has agreed to report the following:

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TAX ASSISTANCE TO PROSPER: CANADA'S WINE-MAKERS, SMALL BREWERS AND JEWELLERS

INTRODUCTION

In the Spring of 2004, the House of Commons Standing Committee on Finance undertook a study of federal tax measures to assist small businesses in certain sectors. As part of the study, the Committee met with representatives of the small brewing, wine-making and jewellery industries on the issue of excise duties and taxes. The Committee also heard from the Department of Finance.

This report briefly summarizes the main points made by each witness during its current and previous presentations to the Committee, and makes recommendations that—if implemented—would help certain Canadian small businesses to prosper, thereby enhancing the economic growth of our country.

THE HISTORY AND IMPORTANCE OF FEDERAL EXCISE DUTIES AND TAXES

A. Federal Excise Duties

Federal excise duties on alcohol, which are required to be paid under the *Excise Act*, predate Confederation. Currently, the *Excise Act* imposes federal excise duties on beer, spirits and tobacco products manufactured in Canada. As well, in 2003, the excise tax on wine was converted to an excise duty. These duties are charged at the time of manufacturing, based on the quantity of goods produced. Under the *Excise Act*, it is illegal to produce products that are subject to excise duty unless the producer is first licensed as a brewer, vintner, distiller or tobacco manufacturer; the Act also regulates production, distribution and, in some cases, importation. Table 1 shows the excise duty rates for 1987 and 2003. In fiscal year 2002-2003, the federal government collected \$2.0 billion in federal excise duties, of which 25.7%, or \$519.7 million, came from excise duties on beer. This total does not include the excise duty on wine, which was collected as an excise tax prior to 2003. Table 3 presents federal excise duty revenue by source for fiscal year 2002-2003.

Table 1: Federal Excise Duty Rates, 1987 and 2003

	1987	2003
Distilled spirits	\$10.733/litre of alcohol	\$11.066/litre of alcohol
Mixed beverages (up to 7% alcohol)	-	24.59¢/litre
Beer		
Up to 1.2% alcohol	\$1.789/hectolitre	\$2.591/hectolitre
1.2% to 2.5% alcohol	\$9.660/hectolitre	\$13.990/hectolitre
Over 2.5% alcohol	\$19.323/hectolitre	\$27.985/hectolitre
Cigarettes		
Up to 1,361 grams/1,000	\$10.525/1,000	\$27.475/1,000
Over 1,361 grams/1,000	\$12.424/1,000	\$29.374/1,000
Cigars	\$5.799/1,000	\$14.786/1,000
Manufactured tobacco	\$2.433/kilogram	\$18.333/kilogram
Raw leaf tobacco	63.278¢/kilogram	\$1.572/kilogram
Tobacco sticks ¹		\$18.33/1,000
Wine ²		
1.2% or less alcohol	1.79¢/litre	2.05¢/litre
1.2% to 7% alcohol	21.47¢/litre	24.59¢/litre
Over 7% alcohol	44.72¢/litre	51.22¢/litre

Source: *Finances of the Nation 2003*, Canadian Tax Foundation, 2003.

Note: /litre of alcohol = per litre of absolute ethyl alcohol by volume.

¹ Tobacco sticks were taxed as manufactured tobacco up to February 1991.

² Prior to 2003, the excise duty on wine was an excise tax.

B. Federal Excise Taxes

The *Excise Tax Act* imposes federal excise taxes on jewellery and tobacco products manufactured or imported into Canada, as well as on motive fuels, automobile air conditioners and certain automobiles. Until 2003, federal excise taxes were also applied to wine. Federal excise taxes are payable at the time of delivery to the purchaser, and are based either on the quantity or weight of product sold, or on its value. Licensing is required, but small manufacturers — those with annual sales under \$50,000 — are exempt from both licensing and the requirement to pay federal excise tax. In fiscal year 2002-2003, the federal government collected \$7.4 billion in excise tax revenue, of which 2.2%, or \$161.8 million, came from the federal excise tax on wine and 1.2%, or \$87 million, came from the federal excise tax on jewellery. Revenue collected from federal excise taxes in fiscal year 2002-2003, by source, is shown in Table 3.

Federal excise taxes were introduced in the 1918 federal budget as taxes on luxury goods, such as jewellery. The rationale for such taxes was, according to the Minister of Finance at the time, not only to raise needed revenue but also to control “extravagant and luxurious expenditure.”¹ Since that time, the focus on luxury goods has been expanded, and these taxes now also apply to tobacco products and — until 2003 — wine, among other goods. Current economic theory supports the raising of revenue by taxing activities with social costs, such as smoking and pollution (commonly known as “sin taxes”), in order to reduce the prevalence of these activities and to ensure that the “hidden” costs of such actions are fully priced.

Although the scope of federal excise taxes was broadened considerably over time, it was reduced with the introduction of the federal Goods and Services Tax (GST) in 1991. The introduction of the GST also led to an increase in federal excise tax rates on tobacco and wine, since the revenue from the 7% GST was less than that from the old federal sales tax rate of 19%. This increase in federal excise tax rates produced the same combined federal sales and excise revenues as under the old system. Federal excise tax rates, both before and after the introduction of the GST, are shown in Table 2.

Table 2: Selected Federal Excise Tax Rates, 1990 and 2003

	1990	2003
Gasoline (motor and aviation) ^a	8.5¢/litre	10¢/litre
Diesel and aviation fuel	4.0¢/litre	4.0¢/litre
Cigarettes	10.688¢/5 cigarettes	25.888¢/5 cigarettes
Manufactured tobacco	\$14.254/kilogram	\$35.65/kilogram
Cigars	40%	6.5¢/cigar or 65%
Tobacco sticks	\$14.254/kilogram	3.965¢/stick
Automobile air conditioners	\$100/unit	\$100/unit
Jewellery ^b	10%	10%
Watches, clocks	10%	10% ^c

Source: *Finances of the Nation 2003*, Canadian Tax Foundation, 2003.

Note: Excise taxes are levied on automobiles according to weight but are not shown in Table 2.

^a Effective 1989, leaded gasoline is taxed at a rate that is 1¢/litre higher than that shown for unleaded gasoline.

^b Jewellery valued or priced at under \$3 is exempt.

^c 10% of the amount by which the sale price or duty paid value exceeds \$50.

¹ J. Harvey Perry, *Taxes, Tariffs & Subsidies: A history of Canadian fiscal development*, Toronto: University of Toronto Press, 1955, p. 197.

C. Federal Excise Revenues

In fiscal year 2002-2003, the federal government collected \$2.0 billion in excise duty revenue and \$7.4 billion in excise tax revenue. Table 3 lists excise revenue by source for that year. In 2003, the excise tax on wine was converted to an excise duty.

Table 3: Federal Revenue from Excise Duties and Taxes by Source, 2002-2003

Excise Duties	Revenues (\$ millions)	Share (%)
Beer	519.7	25.7
Spirits	391.1	19.3
Spirit coolers	16.6	0.8
Cigarettes	989.4	48.9
Cigars	0.2	0.0
Manufactured tobacco	107.0	5.3
Other	0.1	0.0
Total excise duties	2,024.1	100.0
Excise Taxes	Revenues (\$ millions)	Share (%)
Wine	161.8	2.2
Jewellery	87.0	1.2
Motive fuel - gasoline	4,536.1	60.9
Aviation gasoline and fuel	22.3	0.3
Diesel fuel	433.9	5.8
Cigarettes	1,756.6	23.6
Cigars	34.3	0.5
Tobacco	151.9	2.0
Smokers' accessories	71.6	1.0
Automobiles	10.9	0.1
Automotive air conditioners	169.1	2.3
Sundries	7.5	0.1
Total excise taxes	7,443.1	100.0

Source: 2003 Public Accounts.

Note: The excise tax on wine has been converted to an excise duty.

REVIEW OF EXCISE DUTIES AND TAXES

In September 1996, the Auditor General of Canada examined federal excise duties and taxes on selected commodities and concluded that a revision of the *Excise Act* was urgently needed. With respect to the jewellery industry, the Auditor General observed that “there is extensive evasion and avoidance of jewellery excise tax through underground activity, resulting in a federal excise revenue loss of some \$30 million annually.”² The Auditor General did not offer any solutions to this problem, advising that the Department of Finance “needs to continue to assess and seek solutions in consultation with the industry.”³

The Department of Finance responded to the Auditor General’s recommendations with a 1997 Discussion Paper on proposed revisions to the *Excise Act*.⁴ The Discussion Paper, however, did not question the appropriateness of the taxes and of the tax rates stipulated in the Act; instead, it focused on the administration of the tax. The Discussion Paper was followed by the *Excise Act, 2001*, which established a new legislative framework for the federal taxation of spirits, wine and tobacco products, replacing the existing tax structure with an approach reflecting current industry and administrative practices.

CANADA’S WINE-MAKERS

The Canadian Vintners Association shared with the Committee, during both the 2003 pre-budget consultations and the current study, its views about the competitive disadvantage faced by the Canadian wine-making industry as a result of federal excise duties. During the 2003 pre-budget consultations, the Committee was informed that the excise duty paid by producers of 100%-Canadian quality wine places them at a disadvantage relative to their international competitors, particularly those in the United States. At that time, the Association advocated a federal excise duty exemption and reduction proposal that, in its view, would place Canadian wine-makers on a level playing field with their U.S. competitors.

During its 4 May 2004 presentation, the Canadian Vintners Association shared with the Committee the significant growth experienced by Canada’s wine-making industry in the past decade — in terms of the number of operating wineries, grape acreage, employment and tourism — but noted that the industry is characterized by “aggressive competition, several downward price pressures from

² 1996 Report of the Auditor General of Canada, Chapter 18, available at http://www.oag-bvg.gc.ca/domino/reports.nsf/html/96menu_e.html.

³ Ibid.

⁴ Department of Finance, *Excise Act Review: A Proposal for a Revised Framework for the Taxation of Alcohol and Tobacco Products*, February 1997, available at <http://www.fin.gc.ca/toce/1997/eatoc-e.html>.

imports, high taxation, regulation, provincial monopolies, inter-provincial trade restrictions, high production costs and innovation.”

The Association also described how the Canadian wine-making industry interacts with the federal/provincial/territorial Agriculture Policy Framework. In its view, the industry “produces a high value-added, environmentally friendly, safe, branded, quality Canadian product using increasingly advanced technology, and it does so without import protection or any significant subsidies. ... Further, it levers considerable economic benefit through tourism, culture, and the hospitality industry.” The industry operates without any significant monetary transfers from the federal government, except through crop insurance and related programs, and “the only real aspect of the ... Agricultural Policy Framework that does not extensively apply to the wine sector is that of ‘Business Risk Management.’”

The Committee was told that, at present, the playing field faced by the Canadian wine-making industry is not level, internationally or domestically; the policy and financial support received by many wine-making industries in other countries and by other sectors of Canada’s agriculture and agri-food industry do not apply to Canada’s wine-making industry. Furthermore, the industry operates with no import protection other than an import tariff of 3.74 cents per litre applied to certain countries, although the industry expects that this protection will be bargained away in the current round of World Trade Organization negotiations; at this time, certain competitor countries — including the United States and Chile — are already exempt from the tariff. Moreover, such significant wine-making countries as the United States and Australia provide excise exemptions or rebates to their smaller domestic wine-makers, and the European Union gives its grape and wine sector annual subsidies of more than \$3 billion, exclusive of national and sub-national subsidies.

To level the playing field, and to assist the Canadian wine-making industry to grow and make a greater contribution to this country’s value-added agriculture sector, the Association re-iterated the proposal made to the Committee during the 2003 pre-budget consultations, which it believes would cost the federal government about \$6-8 million annually in foregone federal duty revenues, less increased federal revenues resulting from the increased prosperity of the industry.

Specifically, the Association advocated two options:

- an exemption for 100%-Canadian wine from federal excise duty up to sales of 500,000 litres annually and a reduced federal excise duty rate for annual production levels from 500,000 litres to 900,000 litres, capped at 51.2 cents per litre; or

- rebates equivalent to the proposed federal excise duty exemption and reduction.

The Committee was told that the federal excise duty and the GST on wine cost wine-makers more than \$120 million annually; with the exception of beer and spirits, these costs are not faced by others in the value-added agriculture, food and beverage industries. We were informed that these costs are not borne by wine-makers in such competitor countries as Spain, Portugal, Greece, Germany or Italy, and that excise exemptions or reductions are granted to wine-makers producing less than 250,000 U.S. gallons (more than 900,000 litres) in the United States; excise relief is also given in Australia.

In presenting its proposal, the Association told the Committee that:

- from a World Trade Organization perspective, Canada would be no different from a number of other countries, including the United States and Australia, in providing excise relief for small levels of wine production;
- the federal excise duty reduction proposal is based on the U.S. wine excise tax model;
- whether the federal excise duty on wine is a deterrent to alcohol consumption is debatable, and implementation of the proposal would not necessarily reduce the price of wine, since the benefits would be retained by, and invested in, the wine-making industry, both collectively and individually;
- the federal excise duty proposal would apply equally to all Canadian wine-makers, but only on 100%-Canadian grape-based wine; and
- the tracking of 100%-Canadian grape-based wine for purposes of excise duty should not be difficult, since provincial/territorial liquor jurisdictions and the wine-making industry track wine sales by brand and type (including 100%-Canadian).

As the Department of Finance noted in its presentation to the Committee, “vintners have not suggested that there are any particular problems with the tax system.” Rather, the Department remarked that the Canadian Vintners Association is seeking federal assistance through the tax system to help producers of 100%-Canadian wine. The Department also said that federal excise duty, which is about 38 cents for a typical 750 millilitre bottle, is very low compared to provincial charges on wine, and that very small wine-makers with annual production of less than \$50,000 (about 5,000 litres of wine) are already exempt from the duty.

The Committee agrees with the Canadian Vintners Association that implementation of its federal excise duty exemption and reduction proposal, which is based on the United States wine excise model and thus would be relatively unlikely to face trade challenges, would enhance the prosperity of the wine-making industry in Canada and, consequently, our nation's economic prosperity. In order, however, to better target the proposal to small wine-makers and to reduce the cost of this measure in terms of foregone federal revenue, the Committee recommends that:

The federal government implement, on a priority basis, the federal excise duty exemption and reduction proposal presented by the Canadian Vintners Association to the House of Commons Standing Committee on Finance on 4 May 2004, but modified to begin the phase-in of the excise duty at 400,000 litres. Specifically, the federal government should: provide an exemption for 100%-Canadian wine from federal excise duty up to sales of 400,000 litres annually and a reduced federal excise duty rate for annual production levels from 400,000 litres to 900,000 litres, capped at 51.2 cents per litre; or rebates equivalent to the proposed federal excise duty exemption and reduction.

CANADA'S SMALL BREWERS

Indicating that "Canada's entrepreneur brewing industry is at a critical crossroads" and that "tax reductions will unlock [the industry's] true potential," the Canadian Association of Small Brewers reminded the Committee of the recommendation made in the Committee's November 2002 pre-budget report *Canada: People, Places and Priorities*:

The Committee believes that the current excise duties applied to small breweries are limiting their competitiveness, with negative effects on them and the Canadian economy. From this perspective, the Committee recommends that:

The federal government lower the federal excise tax rate applicable to small breweries to achieve parity with rates in the United States.

In its appearance before the Committee during the 2003 pre-budget consultations, the Association noted that "the federal excise rate of \$28 per hectolitre is almost exactly the same amount of money [paid] to hire an employee or to rebuild capital plant property and equipment." It urged the Committee to continue the support it gave to the Association in the 2002 report, and to

recommend a reduction in the federal excise duty for Canadian small brewers by 60% on the first 75,000 hectolitres of beer produced (from \$27.98 per hectolitre to \$11.19 per hectolitre) to achieve parity with small brewers in the United States; the excise duty is the single-highest federal duty paid by the brewing industry.

During its 4 May 2004 presentation to the Committee, the Association advocated a modified version of its earlier proposal. This earlier proposal advocated a 60% federal excise duty reduction, with a duty reduction savings cap of \$1.2 million per brewery; the anticipated cost in foregone federal revenues was \$14 million per year.

The Association’s modified proposal envisions a duty reduction of 90% for very small brewers, with the federal excise duty reduction lowered gradually to 0% at 75,000 hectolitres, with a duty reduction savings cap of \$684,000 per brewery; the proposal would cost the federal government an anticipated \$11 million annually in foregone revenues. According to the Association, its modified proposal better reflects the reality that the Canadian brewing industry is characterized by a large number of very small brewers and few larger brewers, and would provide relatively greater benefits for smaller and mid-size brewers. Specifically, the proposed schedule is:

Brewery size (hectolitres)	0-2,000	2,000-5,000	5,000-15,000	15,000-50,000	50,000-75,000	75,000-300,000
Number of brewers	51	14	8	8	3	4
Duty reduction	90%	80%	60%	30%	15%	0%
Duty reduction savings/brewer	\$50,000	\$118,000	\$285,000	\$579,000	\$684,000	\$684,000

The Association noted that there are several advantages to reducing the federal excise duty for small brewers:

- Parity with the United States and foreign brewers: of the 95 small foreign brewers currently selling in the Canadian market, more than 50 benefit from 50% excise reductions in their home country, and most major beer-producing countries recognize the specific needs of small breweries through differential tax policies;
- The benefit of being a “tested” tax policy already in place in ten countries, eleven states and eight Canadian provinces: in 1992, the European Union enacted a policy that allows excise-duty reductions of up to 50% for small brewers, and virtually all

beer-producing countries worldwide have implemented similar policies to stimulate growth in the small brewing industry;

- Jobs and other investments in local economies, including reclaiming more than 1,500 jobs lost to rising imports, energizing the job-creation ability of small brewers and safeguarding jobs in 65 Canadian communities: based on the experience of the United Kingdom and with Canadian provinces that have implemented tax reductions targeted at small brewers, 45% of a small brewery's duty savings are likely to be reinvested in production and sales jobs, with 30% directed toward equipment purchases and 25% used to finance marketing initiatives or to pay back-taxes;
- The creation of community anchor businesses and tourist attractions: while provincial tax policies provide important incentives for community investment, the federal excise duty reduction that is being sought would provide an additional incentive for local investment in the long term, with implications for brewery jobs, prosperity in the sectors that serve the small brewers and visitors to the brewery, and the overall viability of the communities in which the breweries are located; and
- Rekindling Canada's brewing heritage, including supporting visible role models: a new generation of brewers is emerging, and international awards are being won because of the quality and variety of the beers produced by Canada's small brewers.

In its appearance before the Committee, the Department of Finance indicated that since the federal excise duty on beer has not increased since 1991, in real terms the duty has declined; moreover, the provinces generally tax beer at "much higher" rates than the federal government. It also remarked that "[f]rom a tax policy perspective, the current excise duty system is fair. ... [It] does not place small producers at a disadvantage relative to large producers or importers. ... What small brewers are requesting is a benefit delivered through the tax system to increase their margins and strengthen their position in the market" We were also told that "[i]t is reasonable to concur that such financial assistance, whether provided through a reduction in the excise duty or by other means, would assist this industry to become more profitable, to expand and to create jobs. Such an outcome would likely occur in most small business sectors were the [federal] government to provide the level of financial assistance proposed by the small brewers."

The Committee continues to believe that the federal excise duty treatment of Canada's small brewers is limiting their prosperity. As a consequence, the Canadian economy is being harmed through job losses and lower levels of job creation, less

community development and reduced viability for those who supply inputs to the industry and who provide services to the tourists who might visit the brewery. We believe that it is in the best interests of the Canadian economy — as well as Canada’s small brewers — for the small brewing industry in Canada to have a more favourable federal excise duty regime, specifically, one that reduces the federal excise duty paid, in order that they can grow and prosper, and create the jobs and community development opportunities that will benefit all of Canada. For this reason, the Committee recommends that:

The federal government immediately implement the federal excise duty reduction proposal presented by the Canadian Association of Small Brewers to the House of Commons Standing Committee on Finance on 4 May 2004. Specifically, the federal government should implement the following excise duty scheme for brewers producing 300,000 hectolitres or less of beer annually:

Brewer size (hectolitres annually)	Duty reduction	Maximum duty reduction savings/brewer
0-2,000	90%	\$ 50,000
2,000-5,000	80%	\$ 118,000
5,000-15,000	60%	\$ 285,000
15,000-50,000	30%	\$ 579,000
50,000-75,000	15%	\$ 684,000
75,000-300,000	0%	\$ 684,000

CANADA’S JEWELLERS

During the most recent pre-budget consultations and the current study of small business tax measures, the Committee was told that the federal excise tax on jewellery is hurting Canada’s \$1.2 billion jewellery industry, leading to job losses and unfair import competition.

According to the Canadian Jewellery Association, the Canadian jewellery industry employs 40,000 Canadians in 5,000 businesses, many of them small, private and family-owned. *Toward a National Diamond Strategy*, a September 2003 document prepared by the provincial and territorial mine ministers and mentioned to the Committee by the Association, estimates that “the jewellery manufacturing industry generates about 40% more jobs for every Canadian dollar of production than home electronic or auto parts. It has the potential to create regional and rural employment in specialized cottage industries.”⁵

⁵ Provincial and Territorial Mine Ministers, *Toward a National Diamond Strategy*, September 2003, p. 38, available at www.gov.nt.ca/RWED/diamond/pdf/nds_doc.pdf.

The *Excise Tax Act* levies a federal tax on the following goods imported, manufactured or produced in Canada “on the duty paid value [imported] or the sale price [manufactured or produced in Canada], as the case may be”:

- 10% on the sale price or duty-paid value over \$50 of “clocks and watches adapted to household or personal use, except railway men’s watches and those specially designed for the use of the blind”;
- 10% on “articles of all kinds made in whole or in part of ivory, jet, amber, coral, mother of pearl, natural shells, tortoise shell, jade, onyx, lapis lazuli or other semi-precious stones”; and
- 10% on “articles commonly or commercially known as jewellery, whether real or imitation, including diamonds and other precious or semi-precious stones for personal use or for adornment of the person, and goldsmiths’ and silversmiths’ products except gold-plated or silver-plated ware for the preparation or serving of food or drink”.

Jewellery valued or priced at under \$3 is exempt from the tax.

At present, according to the Department of Finance, the federal government collects about \$100 million annually in federal excise taxes on jewellery. It is unclear how much the tax costs annually to administer. According to the Canada Customs and Revenue Agency (CCRA), its administrative cost is, at most, \$1.5 million per year; the Canadian Jewellers Association told the Committee that the annual cost is \$7-14 million.

In its 5 May 2004 appearance before the Committee, the Canadian Jewellers Association re-iterated its request for a repeal of this tax, and raised several concerns about this tax. According to the Association, the Act’s \$3 tax threshold suggests that the federal excise tax on jewellery is a remnant from a bygone age. As well, it is the only remaining “luxury tax” still levied by the federal government, and while taxes on alcohol and tobacco can be justified — rightly or wrongly — for health-promotion reasons, there seems to be little justification for the excise tax on jewellery as a luxury tax, since other “luxuries” do not face a similar tax.

The Committee was also informed that, beyond the letter of the law, most of the substance of the federal excise tax on jewellery is formed through regulations and interpretations by the CCRA. The Association remarked that some of these rules seem a bit odd, such as defining manufacturing and producing to include jewellery repair and stone-setting.

As well, complex interpretations of the Act make the federal excise tax on jewellery an expensive, difficult and somewhat arbitrary tax to administer. Furthermore, according to the Association, because Canada's tax system largely moved away from excise taxes with the replacement of the complex Manufacturers' Sales Tax with the more transparent GST, the CCRA no longer has the ability to administer a tax as complex as the federal excise tax on jewellery. As well, the Committee also heard that because of the various nuances in the interpretations related to the excise tax, small retailers are unable to realize the efficiency gains that would arise were they able to automate their computer systems to calculate the amount of federal excise tax they are required to pay.

The Association also noted that, although the federal excise tax on jewellery is levied on imported and domestic jewellery, domestic jewellers face a relatively higher tax burden for three reasons. First, the duty-paid value faced by importers is typically lower than the sale price faced by domestic jewellers. Second, growth in Internet shopping has made it easier to order jewellery from abroad, which is then shipped to Canada, often illegally avoiding duties and taxes. As well, this kind of illegal shipment is but one example of the burgeoning underground economy in jewellery, to which the Association claims the federal excise tax on jewellery is an important contributor. A 1997 Ernst & Young study commissioned by the Department of Finance, and cited by the Committee in the 1997 pre-budget report, noted that 30-60% of Canadian jewellery transactions are illegal trades, although it also concluded that repeal of the excise tax would not have a significant impact on contraband activity and would therefore not generate sufficient GST and income taxes to offset the lost excise revenue. Third, the excise tax effectively acts as a tax on inventories, thereby limiting the amount of jewellery a retailer can store, display and, thus, sell.

In its presentation to the Committee, the Department of Finance disagreed with the characterization of the federal excise tax on jewellery as a "luxury tax," noting that "most jewellery sold in Canada is relatively inexpensive and purchased by average consumers." The Department agreed, however, with the Canadian Jewellers Association that the tax favours imported jewellery over domestically manufactured jewellery and that deficiencies in the tax "make it prone to tax avoidance and evasion." According to the Department, if "the jewellery excise tax were not already in place, it is less than certain that Parliament would want to legislate one today." Eliminating it, however, "would have an impact on the Government's overall fiscal planning."

The Committee believes that the federal excise tax on jewellery is an anachronism that no longer serves any social-policy objectives, nor does it fulfill the qualities that should be sought in a tax: equity, efficiency, ease of administration and transparency. As well, we feel that this tax is resulting in negative consequences for employment and the viability of Canada's jewellery industry. We also note the recommendation made by provincial and territorial mine ministers that the elimination of this tax should occur "to encourage retail sales of diamonds to

Canadians and tourists.”⁶ At the same time, however, we are conscious that immediately eliminating the federal excise tax on jewellery would have fiscal implications. As a result, the Committee recommends that:

The federal government implement one of the following options: phase out the federal excise tax on jewellery over five years; or increase, in increments over a five-year period, the thresholds at which the tax begins to be paid, eliminating the tax at the end of the period. In deciding between these options, the government should consider which option is the more expeditious and involves the greater administrative simplicity for the jewellery sector.

CONCLUSIONS

In this report, the Committee has made recommendations designed to assist certain small business sectors. We recognize, however, that there are many other small business sectors that would benefit from the implementation of appropriate tax changes and welcome comments from these sectors during the pre-budget consultations for 2004. At that time, we will consider what measures might best assist Canadian businesses in a fiscally responsible manner.

As well, the Committee is mindful that the number of worthy proposals exceeds the ability of the federal government to finance them in a fiscally responsible manner. From this perspective, and reflecting the current priorities of the Committee, we urge the federal government to take immediate action on the recommendation regarding the federal excise tax on jewellery, to be followed quickly by the implementation of the proposals we recommend for Canada’s wine-makers and small brewers.

Finally, the Committee urges the federal government to discuss these proposals with the provincial/territorial governments with a view to ensuring that federal duty and tax relief does not result in higher provincial/territorial taxes or other charges.

⁶ *Toward a National Diamond Strategy*, p. 46.

REQUEST FOR GOVERNMENT RESPONSE

Pursuant to Standing Order 109, the Committee request that the government table a comprehensive response to this report.

A copy of the relevant Minutes of Proceedings (*Meetings Nos. 2 to 3 including this report*) is tabled.

Respectfully submitted,

Massimo Pacetti, M.P.
Chair

