Fostering Entrepreneurs and Small Business
A 10 Point Action Plan for Competitiveness & Growth

MNP 2019 Pre-Budget Submission to the Standing Committee on Finance

Thursday, September 20, 2018

We are pleased to make a submission in response to the House of Commons Standing Committee on Finance invitation to provide our views on the topic of Economic Growth: Ensuring Canada's Competitiveness.

MNP LLP (MNP) is a leading national accounting, tax and business consulting firm in Canada. MNP proudly serves and responds to the needs of our clients which include more than 150,000 private enterprise and small business clients, and 16,000 farms throughout Canada.

Fostering Entrepreneurs and Small Business

A 10 Point Action Plan for Competitiveness & Stimulating Growth

1. Lower the combined corporate tax rate from 27% to a more modest rate of 20% and to reach a combined personal tax rate that is below 50%.
2. Provide for 100% write-off of capital cost allowance on qualifying capital asset purchases to inspire capital investment.
3. Expansion of personal tax bracket thresholds based on a higher multiple of the bottom bracket threshold.
4. Revise the taxable capital limits to account for inflation.
5. Allow full tuition credit transfers to parents of children in post-secondary institutions and reintroduction of the education tax credit.
6. Reduce uncertainty, red tape and bureaucracy on tax compliance for entrepreneurs and small business.
7. Expand provisions of the Income Tax Act (ITA) to allow for families to use their Lifetime Capital Gains Exemption (LCGE) in a bona-fide succession, while preserving capital gain treatment in other situations where the full succession is not imminent, but there is a transition in ownership.
8. Allow small business rollovers for private business, similar to farm rollovers.
9. Maintain the current estate tax regime.
10. Increase the threshold for passive investments held inside small business corporations to protect entrepreneurship.

GLOBAL COMPETITIVENESS

Canada's economic landscape is changing, and as Canadian businesses await Canada's response to emerging US economic and tax policies, our economy has somewhat stalled. Recent US tax reform and policy decisions have resulted in the US becoming more business friendly and tax competitive; this will draw capital and skilled labour away from Canada to the larger US marketplace. Foreign investment is also overlooking Canada for the more favorable US business environment. In light of this, our clients are asking us to analyze whether it makes sense for them to relocate their businesses, a move that would further erode the economy. Tax competitiveness is only one factor that a business will consider when making investment decisions, but it is a significant one that drives individual behaviours.

When evaluating competitiveness, especially for entrepreneurs and small business owners, one cannot overlook the overall personal tax rates and bracket thresholds – Canada's top personal tax rate currently averages 53% (including provincial taxes) which is the 6th highest among the OECD countries[1].

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[1] OECD (2018), Taxing Wages 2018, OECD Publishing: Table 1.7 Top Statutory Personal Income Tax Rate and Top Marginal Tax rates for Employees. https://stats.oecd.org/Index.aspx?DataSetCode=TABLE_I7

From an economic perspective, higher taxes reduce the incentive to work, make capital investments and take risks. Taxes paid are a result of two components, both of which must be considered in tandem – the tax rate and the computation of income.

The simplest way to remain competitive and stimulate growth is to lower the combined corporate tax rate from 27% to a more modest rate of 20% and to reach a combined personal tax rate that is below 50%. In combination with the reduction of tax rates, we also propose actionable incentives that can further encourage growth within the Canadian economy:

Inspire capital investment

Canada should allow accelerated capital cost allowance provisions similar to those in the US for an immediate 100% write off on qualifying capital asset purchases. While this is a reactive solution to the US Tax Reform, this is a much-needed incentive to tackle capital outflow to the US. This would have **no impact on overall tax revenue**.

Promote and Protect Entrepreneurship

The Department of Finance (Finance) must find a better way to balance the risk of entrepreneurship with the rewards. The cumulative effect of various tax changes over the last five years has left private companies with reduced incentive to grow their business or even to remain in business (TOSI, minimum wage increases, carbon tax levies, small business deduction (SBD) reform, ECP reform, CPP increases, s.55 reform impacting divisive reorganizations for private corporations and TFSA contribution reductions). Tax legislation needs to be supportive and entrepreneurial to stimulate growth and re-investment of the business (for example, the July 2017 proposals were overwhelmingly perceived as disincentives for entrepreneurs who are taking risks).

A higher threshold for passive investments held inside small business corporations is needed. Business owners take risks and must have access to capital to take these risks; they also need to be rewarded.

Personal tax bracket thresholds should be expanded – Finance should examine increasing the threshold at which the top personal tax rate applies. Consider whether the top marginal federal tax rate should be levied based on a higher multiple of the bottom bracket threshold.

Taxable capital reform – this limit was first introduced in 1989 at $10 million and since then there have been no changes to allow for inflation where other parts of the ITA have been amended for this. Additionally, the corresponding reduction to the SBD has not changed since this date.

Promoting an educated task force – provide full tuition credit transfers (versus restricting transfers to $5,000 to parents) to recognize that parents fund a significant portion of children's post-secondary tuition. A reintroduction of education credits for students will also assist those individuals who wish to further their education; perhaps consider a grant of additional credits for students enrolled in fields in which the government wants to invest.

Reducing uncertainty, red tape and bureaucracy, particularly in aspects of tax compliance for entrepreneurs and small business. This alone would lead to simplification of tax legislation. For example, the new TOSI rules will likely cost entrepreneurs time and money in legal and accounting fees to support something as simple as a dividend payment.

Ease Succession Anxiety

Finance has indicated they are considering changes to family succession. Canadian business owners experience a penalty for succession of a business within their family, such that there is often a double tax component – the vendor parent must pay tax to transition the business, and the successor must also have after tax dollars to fund the acquisition. This penalizes family succession planning when compared to the transfer the business outside the family unit.

A long-standing anti-avoidance rule in the ITA prevents individuals from extracting surplus funds from a corporation tax-free by recharacterizing proceeds of disposition received on the sale of shares to a dividend. This rule prevents family succession from being on a level playing field compared to a sale to a third party, as any proceeds previously sheltered by the individual's (or a related individual's) LCGE is excluded from the individual's tax cost.

This rule creates a problem with succession planning: parents who want to transition their business to their child by selling shares to their child's corporation would have any gain on the sale of the business taxed at the higher dividend rate. If the parents utilized their respective LCGEs on a sale directly to their child and the child later sold the shares to a related corporation, that child could face the same dividend tax treatment. This prevents the child from using a corporation to effectively finance the purchase, even where the child is paying fair market value for the business as any third party would. This requires them to fund the acquisition with personal after-tax funds. In contrast, had the parents chosen to sell the shares to an unrelated corporation, any gain realized would be sheltered by any available portion of their LCGEs and/or taxed at the lower capital gains rate.

Considerations:

- Current tax legislation should be expanded to allow for families to use their LCGE in a bona-fide succession, while preserving capital gain treatment in other situations where the full succession is not imminent, but there is a transition in ownership.
- Consider allowing a small business rollover for private businesses, similar to farm rollovers.

July 2017 Proposed Legislation

We caution against the reintroduction of the draft legislation ITA s.246.1 or ITA s.84.1 from the July 2017 proposals. The July 2017 proposed legislation expanded this anti-avoidance rule to include the sale of shares by an individual to a related corporation where the individual's tax cost included tax paid capital gains by unrelated persons. If enacted, these proposals would have substantially increased the cost of passing on a family business to the next generation, putting owners of these businesses in a position where it would be much more tax efficient to sell to a third-party buyer.

The Stealth Inheritance Tax

Interestingly, there has been calls for a "death tax" or "inheritance tax" by some, but Canada already has this. There is a provision in the ITA which results in a deemed disposition of all property on death. This tax causes hardship for many families, as taxes are levied without cash proceeds, requiring families to liquidate businesses without a readily-available market at a time that is often not economically optimal. The same issue does not exist where a deceased has portfolio investments – there is a ready market for the assets, and there is an ability to dispose of liquid assets.

Our Recommendations

We strongly believe in a "Made in Canada" approach to tax competitiveness. Canada must be viewed both domestically, and on the world stage as a desirable country in which to do business and innovate, thus reaping the economic benefits of increased employment and spending. We need to react to the US tax legislation given the amount of cross border business activity, but we need to ensure **Canada remains unique** and the action items make sense from a policy perspective.

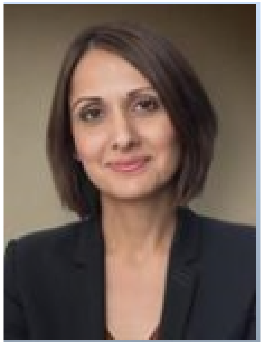
Given that small businesses (i.e. fewer than 50 employees) contribute on average 30% to national GDP[2], the government needs to ensure that tax policy and legislation protects Canadian entrepreneurs and small business – throughout the business cycle, from start up to family succession to death.

We would be pleased to further discuss the technical merits of our comments and recommendations in this submission with Finance if required.

[2] Innovation, Science and Economic Development Canada, "Key Small Business Statistics," June 2016.

Amanjit (Am) Lidder, CPA, CA

Senior Vice President, Taxation Services	T: 778.571.3535	E: Amanjit.lidder@mnp.ca



Am is the Senior Vice President of Taxation Services with MNP. As the leader of MNP's Tax Group, Chair of MNP's Tax Executive Committee and a member of the firm's management team, she oversees all facets of the firm's tax practice providing management and strategic guidance to tax specialists across Canada.

Am has extensive expertise in Canadian taxation, providing a wide range of tax planning and compliance services to mid-market organizations and their shareholders. Working one-on-one with clients, she delivers effective advice and strategies for corporate and personal tax planning, estate and succession planning and corporate reorganizations, as well as merger and acquisition planning. Am strives to fully understand her clients and their businesses, allowing her to tailor solutions to their objectives.

Am has been involved in and presented at numerous tax conferences hosted by CPA Canada and the Canadian Tax Foundation. She is also active in the tax education community, previously serving on the CPA Canada Education Committee, the Advisory and Planning Committee for CPA Canada's National Conference on Income Taxes and on the CTF British Columbia Tax Conference Program Committee. Currently Am is an active member of the CPA Canada Tax Advisory Committee.

Am is a Chartered Professional Accountant (CPA), qualifying as a Chartered Accountant (CA) in 2001. She received a Bachelor of Commerce degree from the University of Northern British Columbia in 1998. Am previously served as a Director on the MNP Board.

Kim Drever, CPA, CA

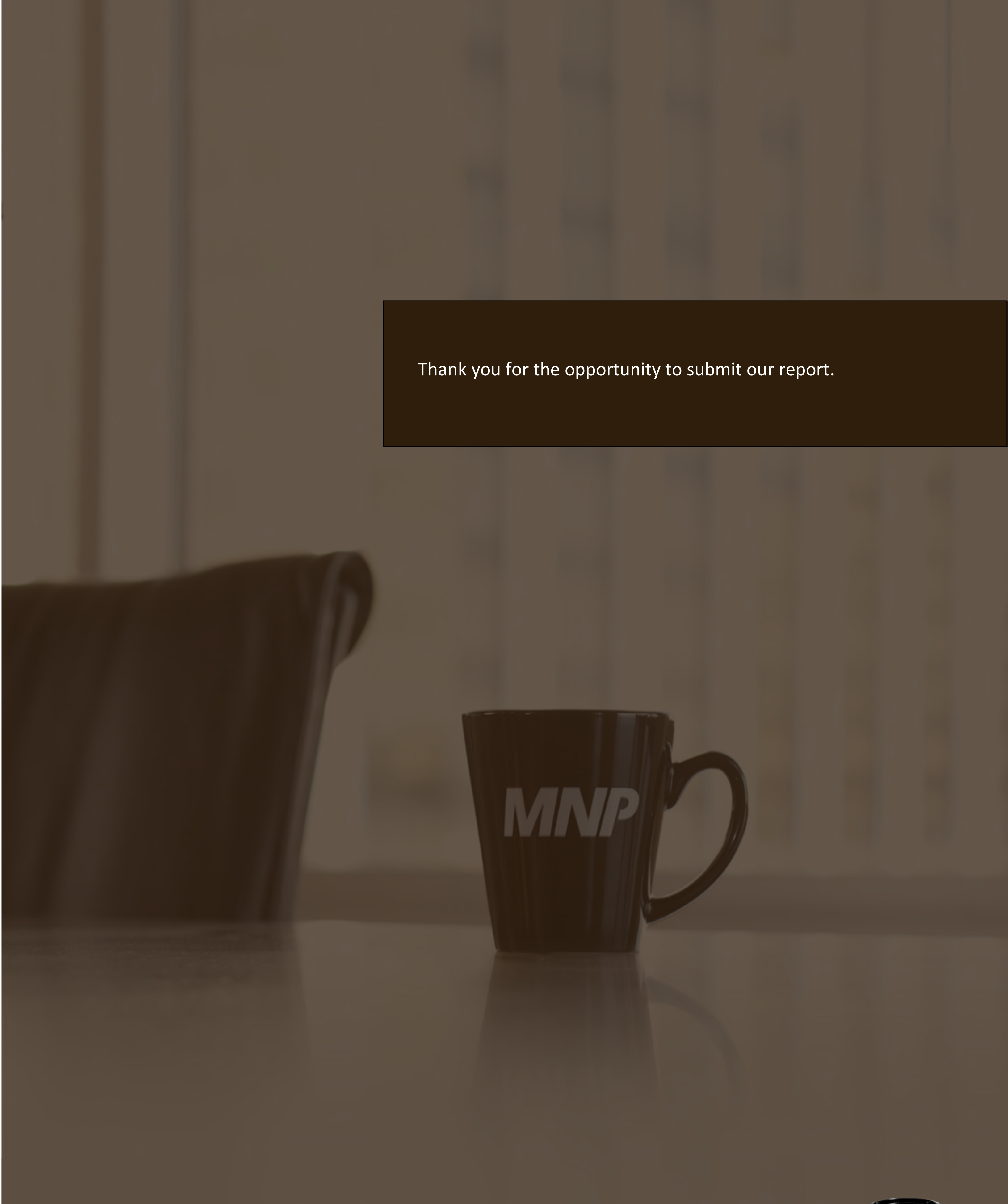
Partner, Taxation Services	T: 780.832.4287	E: kim.drever@mnp.ca

Kim is a Partner and the Regional Leader of MNP's Taxation Services group for the Peace Region. Working out of Grande Prairie, Kim helps clients of all sizes throughout the region by delivering innovative tax, structure and reorganization solutions tailored to their specific needs.

Working one-on-one with her clients, Kim delivers strong advice and guidance that helps clients with Canadian corporate reorganization tax planning. She plans appropriate business structures while preserving wealth and ensuring the family needs are considered. In addition to internal reorganizations and succession planning, Kim assists in tax and structure planning for purchase and sale of businesses. She has experience with businesses in a broad range of industries, including oilfield services, forestry, construction, hospitality, agriculture and professional practices.

Kim develops and delivers tax education throughout the firm to MNP's specialty tax group and its partners. She also speaks to numerous business groups and is invited to participate in tax or financial panels for conferences. Kim has presented at the Canadian Tax Foundation Prairie Provinces Tax Conference and tutored with CPA Canada for advanced tax courses.

Kim holds the Chartered Professional Accountant (CPA) designation, qualifying as a Chartered Accountant (CA) in 2001, and graduated Beta Gamma Sigma with a Bachelor of Commerce from the University of Calgary in 1999. Kim is involved in her community, previously serving as co-chair Finance for the Arctic Winter Games 2010 and currently the chair for the Grande Prairie Regional Hospital Foundation. She is also a member of the MNP Tax Executive Committee and is a Director on the MNP Board.



Thank you for the opportunity to submit our report.