Standing Committee on Finance

EVIDENCE

Thursday, September 28, 2017

Chair

The Honourable Wayne Easter
The Chair (Hon. Wayne Easter (Malpeque, Lib.)): I call this meeting to order.

Pursuant to Standing Order 108(2), this meeting continues our study of tax planning using private corporations. This study will provide contributions from this committee to the Department of Finance’s consultations.

I want to welcome the witnesses here this morning. I know a number of you had a fairly short time to prepare and make arrangements to get to Ottawa. This is an important issue, and I want to sincerely thank you for making the effort to come and state your point of view on this important issue.

We'll start with the Canadian Centre for Policy Alternatives.

Mr. David Macdonald (Economist, National Office, Canadian Centre for Policy Alternatives): Thank you very much, Mr. Chair.

I'd like to thank the committee for the invitation to attend this morning.

Of the three measures proposed, given the time, I'd like to constrain my comments to the income sprinkling portion, although I'm happy to respond in the question period to questions on the other issues. I'll also refer you to my recent report “Splitting the Difference: Who really benefits from small business income splitting?” It contains more detailed analysis than I'll present verbally today.

Data in that report and presented here today utilizes Statistics Canada's tax modelling software to determine statistically accurate impacts of small business income splitting.

What's immediately clear is how concentrated the benefits of income sprinkling are among Canada's richest families. The top 20% of families receive 91% of the tax benefit from the income sprinkling of CCPC dividends. The top 5% of families, making over $216,000 a year, get half of the benefits. The bottom 70%, including essentially all middle-income families making under $100,000 a year in combined pre-tax income, share only 3% of the benefits of small business income splitting. The households that benefit the most are almost exclusively male headed.

Despite all the fuss, the benefits are incredibly narrow, even among families receiving CCPC dividends. Of the 904,000 economic families receiving such dividends, 13% could be using income splitting, although assuming that all CCPC dividends wouldn't pass the reasonableness test, clearly representing an upper bound. Put another way, at least 87% of small business families don't benefit from income splitting.

Further refinement reveals that only about 5% of small business families are actively using income splitting. They would likely fail the reasonableness test and, therefore, be impacted. This represents only 0.3% of all Canadian families.

The federal annual cost that I've estimated in 2017 is $280 million, with a provincial cost of $110 million, for small business income splitting. Interestingly, the average tax benefit is lower than recent rhetoric would suggest, even for families in the top 1%, making over $416,000. The average benefit is only $10,000 for those receiving a net benefit.

Professionals are far more likely to be using this tax strategy, statistically. Most likely to benefit are families with a household head in health care. This group is going to contain doctors and lawyers, where 26% of families are receiving a benefit of over $1,000 from small business income splitting. The second most likely group is a broad grouping of professionals, including lawyers and accountants. The third is a grouping of real estate and insurance salespeople; these types of businesses are not generally thought of as traditional small businesses. In fact, the agriculture category, which would contain family farms, and the accommodations and food services category, which would contain things like family restaurants, are about 2.5 times less likely to see a net benefit from small business income splitting compared with families with a head in health care.
Given the concentrated nature of benefit by professionals and in high-income families, I'd encourage this committee to continue on its path to close income sprinkling for CCPC dividends. That being said, I'd also encourage this committee to consider bigger fish when it comes to tax expenditures, including the stock option deduction and things like the capital gains inclusion rate. Hopefully, these can be part of a larger public discussion on reviewing tax expenditures.

Thank you. I look forward to your questions.

The Chair: Thank you.

We'll now turn to the University of Ottawa.

Mr. Poitras, I think you were notified yesterday at four o'clock.

Professor Stéphane Poitras (Associate Professor, School of Rehabilitation Sciences, Faculty of Health Sciences, University of Ottawa): Yes.

The Chair: That's really....

Prof. Stéphane Poitras: That's part of the professor's job: to be quick.

[Translation]

Firstly, I'd like to thank the Standing Committee on Finance for its invitation.

Since 2007, I have been a professor at the University of Ottawa School of Rehabilitation. My training and my field of research are in the organization of care, particularly as it relates to musculoskeletal disorders.

I am going to discuss the bill from the angle of doctors' practices, as that is the only perspective I can really speak to.

Health care expenditure data published by the Canadian Institute for Health Information show that in 2014, the most recent year for which data is available, physicians accounted for 21.4%, or $32.5 billion, of all public health spending. However, that amount understimates the total public financial resources allocated to doctors, since there were also funds allocated to doctors in the funding of hospitals and other establishments, for a total of $73.3 billion, or 48.4% of public expenditures. Unfortunately, the institute does not specify how much of the funding given to hospitals and other institutions went to physicians.

Be that as it may, one single profession accounts for one of the highest expenditure items, raking in about a quarter of total public spending on health in Canada. And that percentage has in fact been increasing constantly since 2005.

May I remind the committee that in Ontario, for instance, there are 26 regulated health care professions. In several provinces, doctors may also incorporate. The effect of that is to reduce their tax rate considerably, of course, and there are corporate tax deductions. Moreover, by declaring a smaller annual salary, incorporated physicians gain access to numerous generous benefits generally given to the lower-income middle class, such as more generous family allowances, subsidized day care, student bursaries for family members, a lower threshold for medical cost credits, and so on.

Their incorporation has consequences not only for federal and provincial finances, but also municipal ones. I'll give you a somewhat anecdotal example, but it will give you some idea: where I live, a doctor who declares an annual income of less than $40,000 can by presenting his tax assessment obtain a municipal services access card for half the going rate.

It is estimated that approximately 60% of physicians are currently incorporated, although rates have greatly increased these past years. Since incorporation demands a yearly investment of time and money, this indicates that incorporation provides clear tax advantages.

Lower corporate tax rates were brought in mainly to foster job creation in competitive sectors. However, the medical profession is more akin to a monopoly, given the highly regulated and controlled offer of services. As opposed to other employment sectors, doctors run few risks, since they can count on a constant, highly solvent single-payer source of income, the government.

The few jobs created in physicians' offices are essentially a transposition of jobs that would be in the hospitals if doctors' offices did not exist. One can thus question the real net job creation derived from the incorporation of physicians.

The amounts that would be recovered though fairer taxation could be reinvested into initiatives aimed at fostering the health of the Canadian population.

The health care system is but one of the 12 recognized factors that determine health. The funds could be reinvested into other health determinants, for instance a subsidized day care network, which is an early childhood development determinant, or improvements to public transit, which is a determinant of air quality and the physical environment, or a public pharmacare system.

Once again, I thank the committee for its invitation. I will be pleased to answer your questions.

● (0840)

[English]

The Chair: Thank you very much, Mr. Poitras.

Mr. Lovell, you are on video conference. I failed to introduce you at the beginning. Maybe we can turn to you now.

Welcome. I know you're at the apple harvest and a number of other things, so you're pretty pleased not to have to fly to Ottawa. The floor is yours.

Mr. Andrew Lovell (As an Individual): Thank you very much, Wayne. It's great to see a Maritimer up there. It's a nice friendly face. We are in the middle of harvest but it's great to be here all the same.
Thank you, Mr. Chair and committee members, for the opportunity to share my thoughts on the proposed tax plan to use in private corporations. I am speaking to you today as an individual apple producer from New Brunswick and not as a representative of any farm organization. My farm is River View Orchards. I'm a first generation farmer and the 2016 Canadian Outstanding Young Farmer Award recipient. My wife and I have two children, a son who is 12 and a daughter who is five.

I want to start off by saying that there are nearly 200,000 farms across Canada, almost entirely small businesses. They contribute a little over $108 billion a year to Canada's GDP and employ approximately 2.2 million Canadians. Canadian agriculture has been a resilient economic driver for years in Canada. This government acknowledges its immense potential but doesn’t seem to acknowledge the contribution that farmers make to our economy, food security, and climate change.

I appreciate the comments made recently by Mr. Morneau and Mr. MacAulay noting that farmers aren’t the intended targets of these proposed changes, but it doesn't seem to be clear. Unless these proposals are dramatically reformed they will negatively impact family farms across Canada and we will see a decline in the number of farms in our country, adding to our unemployment rate and a decrease in GDP. Both of these will require more tax increases to the middle class to compensate for the increased expense of lost jobs and the lost revenue from the GDP.

On that note I want to share some thoughts on the fact that these proposals were released on July 18 with a 75-day consultation window during harvest when most farmers don't have time to sit down and review tax changes with their accountants. I hardly have time to spend with my family sometimes. For many farmers it was weeks before the potential consequences for farmers started to become clear and I'm still hearing of new ways they could affect my business. Since that time, I don’t think I’ve had a conversation with another farmer where this issue hasn't come up.

While the target may be a select group of wealthy individuals, the current proposals don’t line up with that mark. To give you a sense of what I mean I'll lay out a few potential issues.

There's income sprinkling. Family farming isn’t a nine-to-five job. Families live on their farms and work takes place at all hours of the day with family members contributing in countless ways. There aren't any punched cards here. I understand the intent is to account for those contributions but the intent and the reality of the test are very different things. How can any test truly account for all the ways family members help out on the farm, not to mention the subjective introduced through the CRA? Farming is definitely a family affair. Making decisions to invest in the future requires capital and certainty. Even playing by the book, the vagueness and uncertainty this test introduces creates new risks and questions I need to consider. It leaves me wondering if it is worth it to expand or to even keep going.

The strictest test applied to 18- to 24-year-olds further complicates this. Farm children don't take the ownership of farms in a vacuum. My son Robert has been involved in the operation from a young age and he’s 12 today. Even when he goes away for school as he gets older or works off farm, I know he’s still going to come home and contribute to the farm that he loves. In fact, he already grows his own strawberries and gourds, which he sells himself. Will these contributions pass the CRA test?

If Robert were to have shares in my farm corporation would any dividends he received be reasonable? I ask about him, alone, for now because my daughter is still a little young to work, although she certainly keeps her mother and I working. These questions affect my ability to plan for the future.

Then there are the changes to the capital gains exemption and the treatment of capital gains. The new limitations on access to the capital gains exemption also complicate passing farms from one generation to the next. I need to plan succession. I have to do this in advance to ensure my farm stays within my family. How is doubling my tax fair if I want to pass the farm on to my children?

Farming is capital intensive and my business is my retirement savings plan. Passing along the farm is already complicated and this just limits the options I have to make it work for both parties. When you factor in the proposed changes on converting income to capital gains that incentivize selling the farm outside the farm, difficult financial decisions must be made as to whether to maintain the family farm, take on punitive tax liability, or simply sell to a stranger.

These aren't decisions that farmers or parents should have to make. Farming is part of our heritage. Traditions would direct us, as farmers, to pass the farm to our children. Are my children valued less today than they were 100 years ago? I don't think so.

On passive investment income, investments are held within corporations for a variety of reasons. They can help manage income declines or ensure you have capital gain to invest when the opportunity arises. Passive investments are already taxed at 50%, and I've seen tax rates of over 70% identified with these proposals. Again, this raises new questions around how to plan for the future.

Farming already faces volatility from weather, diseases, pests, and the market, just to name a few. Canada's tax policy should be about not introducing new barriers, but about managing risk and growing my business. This year, we had a drought in New Brunswick. I am facing huge crop losses. How do I plan for Mother Nature?

I'd like to speak a little about my thoughts on potential solutions.
First and foremost, farmers across Canada have no issue with ensuring that everyone pays their fair share, or with government addressing abuses in the tax system. In fact, when we look at dollars generated on farms, they are probably multiplied five or six times inside our economy. However, changes extend far beyond tax avoidance among wealthy Canadians. They impact all private corporations. Some of the capital gains changes would even affect qualified farm property residing outside of corporations. It's not just incorporated farms that are affected.

I appreciate Mr. Morneau's comments when he said that he wanted to see family farms succeed, and that family farms weren't the intended target of these changes. There is a wide gap between that intent and the reality of what the current proposals would do to farms and other small businesses. While these may be unintended consequences, they are not minor, and they would have an impact on farms across Canada unless significant changes are made. This means exempting farm income from income sprinkling proposals, exempting farm property from the new capital gains rules, and working to find a way to truly differentiate real intergenerational transfers.

Farm groups across Canada are ready to work on solutions, but timelines are a concern. I suggest taking a step back and considering removing all farms from this proposal so they don't end up as collateral damage.

With that, I would like to thank you for your time. I welcome any questions you might have.

The Chair: Thank you, Andrew, and thank you for your time and that heartfelt presentation.

Mr. Goulet.

Professor Guy Goulet (Professor of Taxation, Université du Québec en Outaouais): Good morning.

Mr. Chair and members of the committee, thank you for the invitation to come to address you here.

I have been a professor of taxation at the Université du Québec in the Outaouais since May 1, 2015. My interests and field of research are mainly in the area of aggressive tax planning, whether by SMEs or others.

Before joining the Université du Québec in 2015, I worked in the income tax area for over 25 years, about half of that time being spent at the Canada Revenue Agency. When I began at the agency, I worked as a tax avoidance auditor. Afterwards, I worked at the agency, here in Ottawa, for the Income Tax Rulings Directorate.

Before joining the agency, I worked for a little over 10 years for a tax accounting firm. My clients were SMEs for the most part. And so I worked in tax planning for SMEs.

In short, I have worked in taxation since 1990.

There is no doubt that the proposed reform will be changing the tax planning landscape for SMEs. That is why I am here. I like putting things in layman's terms, I like to understand the rules and explain them. That is what I have been doing in the media since July 18. On several occasions I have had the opportunity of commenting on the file, or rather of explaining the rules and helping people to understand the tax policy.

It must be said from the outset that tax planning, either through income splitting or passive investments, that is to say the first two categories of measures, was legitimate and acceptable in tax policy. It was a change in tax policy. The fact that people used it does not mean that it was a loophole.

The third category of measures involves the conversion of dividends into capital gains. These are very specific measures that are intended to plug holes, if you will. There are tools in the act, but the government did not have much success regarding certain transactions. Tax planners were very creative in finding ways to bypass the law. That is why certain more specific tools were created, in order to prevent the possibility of tax avoidance.

My specialty is tax avoidance. Although I understand the overall system well, I have a few comments or reservations as to the last category of measures, that have to do with tax avoidance. Measures have been proposed that will certainly solve the problems, but may cause collateral damage in the case of legitimate transactions. This is going to cause some uncertainty.

This week, the Department of Finance held an information day with some tax specialists' associations. They were told that the purpose of these new measures was to counter tax avoidance transactions, but the fact remains that this is creating some uncertainty.

I am not here to lobby nor to exert pressure for either side. I am at your disposal to answer questions or comment the proposed measures in a general way.

Thank you very much.

The Chair: Thank you very much, Mr. Goulet.

We'll turn to Mr. Merrigan, who is a partner with Poole Althouse in Newfoundland. The floor is yours.

Mr. James Merrigan (Partner, Poole Althouse, As an Individual): I'd like to thank the committee for the opportunity to speak to you today.

My area of practice is corporate commercial, and my clientele is primarily small business, so while I'm applying some of my knowledge to these matters, I'm also hoping today to pass along the concerns of my clients, the real people on the ground who are going to be affected by these changes and who have studied this intently because it impacts them.

I would like to put three propositions before the committee.
First, that income splitting, as it is currently structured, is fair and puts self-employed people in the position to achieve the same economic circumstances as a similarly compensated employed person. Second, the proposed changes will harm family businesses in particular. Third, these changes will harm the most productive job-producing sectors of our economy.

Dealing with the first point that income splitting is fair, the Department of Finance proposal provides an example of an income-splitting individual named Jonah, who has a company, and an employed person by the name of Susan, who has a job. A nice chart shows their economic circumstances, but leaves out taxable and untaxable benefits that Susan is provided by law. The payroll burden or the employer contributions to those benefits amounts to 15% to 18% of the value of her income, which she receives on top of her taxable income in the way of medical, dental, disability, vacation, and pension.

These numbers are conspicuously absent from the Department of Finance chart. I provided you a brief that adds them back in. As compared to the 15% tax avoidance that our Jonah might achieve, Susan's 15% to 18% in benefits is substantial and puts them, at the end of the day, in the same position in terms of disposable income, which I think is a true measure of fairness that ought to be applied.

This is to be contrasted to the circumstances of an employee who is compensated by way of stock options. For amusement's sake, let's call that employee Bill. Bill would pay lower taxes on employment income than either Susan or Jonah, currently in the nature of approximately 26%, so the current system treats Susan and Jonah fairly. If you alter it so that Jonah cannot income split, Jonah's real, after-tax disposable income will drop 15% to 18% and put him substantially behind Susan. Of course, our fictional Bill will be far ahead of both of them at the same income level because we treat stock options as a capital gain.

If you really wish to seek fairness in the tax system, you need to leave income splitting or, and this is the political thing nobody will touch, you need to look at taxing tax-free benefits, which I don't think will go over well. You would also need to deal with the fact that people compensated by stock options receive a substantial benefit, which I have read is in the order of $840 million a year from the treasury.

The second point I would like to make is that with respect to family business. The mechanism by which income splitting is being ended is by amending the definition of the tax on split income, or TOSI. This is being done in a way that punishes related parties. They will be taxed at 52%. This ignores the reality that when small businesses start, their primary capital investors are friends and family. When you go to a friend or a family member and ask them to invest in your business, they make the rational choices to invest in the business. They will make the rational choice to invest with other people, and many small businesses will will cap what they can gain and will punitively tax them at 52%. When you go to a family member, you will be saying to them you would like them to invest in a new business you're starting. There's a fifty-fifty chance they'll lose everything and they may not get anything in the way of compensation.

If you drill down on the rules on loans, what CRA looks at as a reasonable return on investment is 1%. The proposition for a family member to invest in your new business would be, you have a fifty-fifty chance of losing everything, and you can get a 1% per annum return on that investment.

What's going to happen ultimately is that families will not make rational choices to invest in the business. They will make the rational choice to invest with other people, and many small businesses will simply never come into existence. If you look at the most successful businesses in the Canadian economy, half of them are family businesses. The Irwins, the Reitmans, and the McCains were businesses that were all started by families with shareholders that are family members, and they drive our economy forward at the highest end.

That brings me to my third point. The most productive job-producing portion of our economy is small business. According to StatsCan's 2015 numbers, 70% of private sector jobs are small businesses with between one and 99 employees. They are the drivers of the economy. The intent of these changes is to go to the top third, the $73,000 and above bracket in small businesses. That is what is driving your private jobs, to the tune of 70%.

The people affected, as I understand it, are approximately 90% of those 70% of jobs. If you impact these people—as one person put it, collateral damage—the collateral damage will be across 60% to 70% of the job-producing economy. When you make things difficult for small business, you make things difficult for Canada.

The way to end income sprinkling amongst a select few is through the definition of TOSI. Changing the definition of TOSI in this fashion has enormous consequences, from the intended recipients of the $500,000 professional right down to the family farm. In the way of productive suggestions, you need to stop looking at the change of the definition of TOSI as a way to do this. If you're targeting at a very narrow, small, and specific demographic of the CCPC, you need to specify them by income band, and if need be by profession. You will need to be very specific and you will need detailed regulations.

Frankly, the consequences of this approach, whatever its intended target is, will be massive and devastating to the small business community and the Canadian economy will suffer.

Thank you.

The Chair: Thank you very much, Mr. Merrigan.
You did mention that you had developed a new chart to show a different comparative with finance. I haven't seen that. Make sure the clerk gets a copy so committee members can get a copy of that. Thanks.

Mr. James Merrigan: Mr. Easter, I did provide it to the clerk.

The Chair: Okay, she has it.

Mr. James Merrigan: Unfortunately, given the time frame, she was unable to get it through translation. I'm advised the committee will have it shortly.

The Chair: That will be dandy. Thank you.

Turning to the last panellist, we have Ms. Lahey, professor, faculty of law, Queen's University. Welcome.

Professor Kathleen Lahey (Professor, Faculty of Law, Queen's University, As an Individual): Thank you very much for giving me this opportunity to speak to the proposed changes that are being considered by the government in relation to the small business corporations sector.

I'd like to approach this issue from a slightly different perspective, which is to stand back and say that the changes being considered have become necessary, or some response has become necessary, because Canada has for decades maintained what is called the Canadian corporate income tax integration system, a very unique approach that is not used in quite the same way in many other countries. The goal of this is to receive a steady stream of revenue from corporations, but at the same time to integrate those corporate earnings as if the corporation were not really a separate legal person, by giving dividend tax credits when there are distributions out of the corporations.

This was devised by the Carter commission when it was sitting. It was hammered out into its original form through a great deal of careful, technical development that had, as its goal, ensuring that at the end of the process—regardless of whether there was corporate integration or not—capital gains, employment income, unincorporated business income, and dividends would all be taxed more or less equally so that the goal of equity would be promoted as the dominant goal of the Canadian income tax system.

Unfortunately, because tax is such a politicized area of policymaking, the technicalities required to construct that system in the first place formed easy targets over the decades. Most particularly, with the global, and I dare say Canadian-led move to cut all tax rates, high personal income tax rates and corporate income tax rates gained momentum. This put this integration system under a great deal of stress. The small business corporation rules, which were a unique deviation from the corporate income tax integration system, became particularly vulnerable.

Now, the small business rules have a different policy objective than the integration rules. They were carved out of the integration rules for the specific purpose of showing that governments supported small business corporations and gave them lower tax rates at the corporate level so that they could accumulate after-tax profits more quickly, and therefore, have a supply of after-tax retained earnings that they could invest in research, development, innovation, capital investment, and expansion, and hopefully graduate out of the small business category.

The problem is that as the small business corporate tax rates themselves began to fall, suddenly the financial planning and financial advising community realized that it had become tax inefficient for small business corporations to continue paying people in the family salaries that were held against the standard of reasonableness under the Income Tax Act. They began encouraging people to stop paying themselves salaries, which meant that they stopped accumulating employment insurance, Canada pension plan, registered pension plan, registered retirement savings plan benefits, and other kinds of benefits that corporations can provide. They began to move toward receiving dividend income as a predominant source of income, which was not taxable, which did not produce employment insurance coverage, which did not produce CPP and RRSP coverage.

This sector has become vulnerable as the result of the combined effect of the government focus for over 25 years on cutting all tax rates, creating inequalities between the personal tax rates and the corporate income tax rates, which are at really very low levels not just in Canada but Canada is in the forefront, and creating a class of entrepreneurs who are now, in a sense, being held hostage to the tax planning that they invested in. That is, if they can't continue to receive tax-exempt dividends and split them, they will not be able to then recoup the lost income security benefits that they would have otherwise been accumulating over the past several decades.

I would classify this as a crisis.

It is a crisis in particular for the many family members who have participated in this whole process. I'm talking about women, because it has been women who have been used as conduits for dividends in order to get the family income flow up to the level at which it could sustain the cost of living for the family. All of which meant that the purpose of small business corporations had become to maintain a low-tax lifestyle for that sector and no longer focused on gaining after-tax income in order to begin accumulating, growing, and innovating.

The impact on women, I think, is measurable and significant. In 2007, 20% of all small business owners were women. By 2014, that number had fallen to 15%. That's a significant shift, and this was during a period of time in which the government of the day had put a high priority on trying to get women to become more engaged in entrepreneurial activities and to accept the fact that public sector employment, and employment generally, was not going to be as readily available to women as it had been in the past.
Women are particularly affected. It has been statistically difficult to tease out exactly what that profile looks like. If you take single women as the example, only 20% of all dividends in the country go to single women, but married women are almost fifty-fifty. It's not just the people at the very highest income levels. I think there is a pervasive impact here that is creating an incentive for women to withdraw from what could be income-secure employment insurance, Canada pension plan, retirement, etc., security systems, including maternity leave and so on, and to be induced into putting their efforts into family-managed businesses that have a very different ability to provide income security as compared with the state systems that are much more efficient at that.

Thank you.

The Chair: Thank you very much, Ms. Lahey. I thank all the witnesses for their presentations.

Mr. Fergus.

[Translation]

Mr. Greg Fergus (Hull—Aylmer, Lib.): Thank you, Mr. Chair.

First, I want to thank all of the witnesses for being here.

As the chair said, I have a five minutes in total to ask questions and hear replies, and so I ask you to be very brief if possible.

I am going to put the same question to the six witnesses who are here, and it is relatively simple. Then I will have a second question.

Do you think that the current tax system provides the owners of privately-held Canadian corporations with tax advantages that are not available to unincorporated businesses or wage-earners?

Ms. Lahey, what is your opinion on this matter?

[English]

Prof. Kathleen Lahey: Yes, most definitely there are advantages, but what has to be recognized is that the advantages are not gender equal, and they’re not equal by age, either. This is a system that is actually contributing to the growing income inequality between women and men on an after-tax basis in Canada. Canada has a very low rate of redistribution when it comes to getting women out of that low-income category.

[Translation]

Mr. Greg Fergus: Thank you very much.

Mr. Merrigan, what do you think?

[English]

Mr. James Merrigan: I would say that there are advantages, but there are countervailing benefits that people in corporations lack. Much like the comments of my colleague, we're 20 years into this system. The last major change was in 1999. People have spent 20 years investing in the system, in the Canadian-controlled private corporation. The retirement plan is generally to put money into the company and then to draw that down as dividend income upon retirement.

She is correct that women will be benefiting from that, and that with this change, they could have spent their last 20 years differently. Unfortunately, they can't go back. These changes that will end income splitting will deprive women of pensions that they had counted on as the capital accumulated within the company. With the change in the TOSI rules, this will negatively impact women. There is, in this proposal, no way to unwind that, which is what makes it so dangerous.

[Translation]

Mr. Greg Fergus: What would be your answer Mr. Goulet?

Prof. Guy Goulet: The answer is yes, there are tax advantages to incorporation. Mostly, it allows you to defer income tax, since you pay a lower corporate tax rate, which can be between 14.5% and 22%, or 26%, depending on the criteria. By comparison, an individual is taxed according to a progressive rate which can reach its maximum around $200,000. This can vary by province, but that rate can reach 53%. So there is an advantage to deferring the second part of your tax till later.

The other advantage of the current system is that it allows you to allocate your income among several people, which is impossible to do as an individual or even as an entrepreneur. An individual entrepreneur can't divide up the surplus. The corporate vehicle makes that possible.

The Supreme Court recognized income splitting in a few cases, such as in the McClurg and Neuman cases, and so this is legal. The only thing needed to receive a dividend is to be a shareholder. The Supreme Court ruled that it was not necessary that there be a contribution to the business.

And so a wage earner who earns $200,000 a year has no opportunity to split his income, as opposed to an incorporated entrepreneur who may do so.

That is my answer.

Mr. Greg Fergus: Thank you very much, Professor Goulet.

Mr. Lovell, do you have something to add?

[0915]

[English]

Mr. Andrew Lovell: I guess I look at it in maybe a little bit of a different perspective. I mean I'm looking down the barrel of a gun this year at a crop that is awful because of weather. That wasn't a management issue. To me, if I pay less tax because I'm taking huge risks and I'm employing people and I'm contributing to the Canadian economy, I don't really see that as an advantage, not to me. I see that as an advantage to Canada and to the employees whom I'm providing jobs to.

I'm the one who has everything to lose, so to me it's not an advantage. It's a necessary tool that we have to have so that we can keep our economy growing and moving, hopefully, because as soon as things start to go the other way, we're done.

[Translation]

Mr. Greg Fergus: I'd also like to emphasize that I'm very sympathetic to the farmers' predicament.

I don't know if I have any time left, but I'd like to hear Mr. Macdonald's and Mr. Poitras' answers.
The Chair: Maybe Mr. Macdonald and Mr. Poitras could come in on another question, if they have something further to add on that.

Mr. Poilievre, you have five minutes.

Hon. Pierre Poilievre (Carleton, CPC): Thank you.

To Mr. Merrigan, the government proposes to eliminate the RDTOH—refundable dividend tax on hand. Do you believe this will have the effect of imposing double taxation on the passive income earned within a small business?

Mr. James Merrigan: Yes, and I've met with an accountant and a very good tax specialist regarding that. The impact was between 73% and potentially 93%, and I have one client who's currently, potentially in that 73% to 93% who is simply aghast at losing a life’s work.

Hon. Pierre Poilievre: On this side we've been very cautious to use the more conservative estimate of 73%. Can you explain how these numbers may reach as high as 90%?

Mr. James Merrigan: I actually couldn't follow the argument all the way up to 90%. I met with the accountant. The 73% made perfect sense to me. The 93% seemed to be a bit of a unicorn, but it's very easy when you're the lawyer.

Hon. Pierre Poilievre: Okay.

Mr. James Merrigan: It's very hard when you're the client.

Hon. Pierre Poilievre: We won't talk about unicorns. We'll talk instead about the reality that this will mean double taxation to a level as high as 73%, a number confirmed by the most respected economists and financial experts in the country.

Will you, then, advise your clients who are small businesses to come up with a different vehicle in which to save for their retirement?

Mr. James Merrigan: The client in question is in his seventies. If this goes through, he's pretty well toast.

Hon. Pierre Poilievre: He's toast. Let's say you had 35-year-old clients who are saving within their private corporations for their eventual retirement. They're now facing double taxation at a rate as high as 73%. Would that cause you to advise those young clients to save in a different vehicle?

Mr. James Merrigan: It's all very well and good to say, “Save in a different vehicle”, but the money that you keep in a corporation has three purposes.

The first purpose is to capitalize the company. The second is hopefully retirement. The third is for educational purposes for your children. If you only have a small pot of money at the outset of your company, you have to put it all in.

Hon. Pierre Poilievre: I totally agree. It's the same argument I've made.

I'm curious now. If this does go ahead, you're going to be faced with this double taxation on your clients' savings.

What vehicle will you be forced to advise that he or she save in?

Mr. James Merrigan: I'm a tax lawyer, but I don't advise on the tax outcome. I implement the structure.

The advice being given now is to crystallize any capital gains that you have, so we're doing capital gains dividends. I practised in the area for five years, and I never did a capital dividend until this year. I've done five in the last 14 days.

Hon. Pierre Poilievre: What vehicle would they use for future deposits?

Mr. James Merrigan: There doesn't seem to be a strategy arrived at yet by the accountants that I've discussed this with. It seems to be, take your money out now and do something with it. The inclination is to not keep it within Canada. The consensus among my small pool of clients seems to be to pay what taxes are owing on it and then remove it from the jurisdiction.

Hon. Pierre Poilievre: Will individual pension plans be an option?

Mr. James Merrigan: Individual pension plans will be an option going forward for young persons....

I'm trying to remember. It's PRPP and VRSP. That is certainly a strategy that will be adopted going forward. There will be a lot of money pouring into that area.

Hon. Pierre Poilievre: A lot more money will pour into that area. Who offers those plans?

Mr. James Merrigan: I'd say that would include Sun Life. I looked at a Desjardins product. There's also a fairly good write-up on the Morneau Shepell website.

Hon. Pierre Poilievre: Okay.

The government says there's $28 billion in passive income within companies. If money were forced out by high levels of taxation, are we talking about large amounts of money that would then move into these individual pension plans?

Mr. James Merrigan: Yes, very large amounts.

Hon. Pierre Poilievre: In the billions...?

Mr. James Merrigan: I practise in Corner Brook, Newfoundland, so no, not there.

Hon. Pierre Poilievre: Nationwide...?

Mr. James Merrigan: I'll be honest. In my small community, I'm seeing six and seven figures moving now. What the ultimate destination will be, I can't say. From a town a 20,000, millions of dollars are moving. I would say that, nationwide, that can scale up pretty quickly to be billions.

Hon. Pierre Poilievre: Mr. Lovell—

The Chair: I'm sorry, Mr. Poilievre.

We're going to have to pack it in there.

Mr. Boulcerice.

[Translation]

Mr. Alexandre Boulcerice (Rosemont—La Petite-Patrie, NDP): Thank you, Mr. Chair.

I thank our witnesses for being with us this morning for these important discussions and our work on this.
I think we can agree that the principles of fairness and justice must be the cornerstone of our taxation system. Clearly, according to the current measures, the advantages are not the same for a wage earner as for a person who incorporates, or a small business. The latter have tax reduction opportunities that salaried people do not have access to.

In addition, all of these small entrepreneurs, whether farmers or doctors, tell us that they have depended on these measures for years. In the case of farmers or small local businesses, the children may indeed have contributed to the business’s success. It is also possible that physicians may have been to some degree encouraged to incorporate because we did not have the necessary funds to increase their salaries. It is also possible that some small entrepreneurs do not have access to a pension plan, and passive investments are for them one way of preparing for the future.

Mr. Goulet, as parliamentarians, as legislators, how should we find a balance between these two poles, in your opinion?

Prof. Guy Goulet: That objective is indeed difficult to reach. In reality, the reason for lower corporate tax rates is to allow and facilitate reinvestment. According to what I understand, the government now wants to prevent people from putting money aside in order to fund various plans, as you quite rightly said, rather than reinvesting it.

What can be done in those circumstances? I don't know. However, as someone said, rather than applying the measures to everyone, we could probably target certain activities, perhaps those of professionals who do not generate any economic activity, given, for instance, the number of people they employ. We could start with that, rather than targeting everyone. I must say that this is quite broad for the moment.

I might also mention that among the three categories of tax measures, this is the only one where nothing has been proposed. According to what I understand, there is a consultation going on. However, measures are being proposed regarding income splitting and the conversion of dividends into capital gains. The table has been set, so to speak, in those categories. In the case of this other category, it would probably be advisable to fine-tune things a bit and proceed step by step.

Mr. Alexandre Boulerice: Mr. Macdonald, did you have something to add?

[English]

Mr. David Macdonald: I agree that the goal of the small business tax rate is to do one thing, and one thing only. It's to incentivize reinvestment of profits in the business, if profits are made. It was never designed to be a retirement savings plan, although that's how it's been used. That use has been allowed, so people are planning towards that, which obviously creates a problem.

We already have very generous systems of retirement outside of the small business envelope. They're called RRSPs. They're called TFSAs. They have a separate set of rules. They have particular limits that need to be abided by. When people retire, there are conversion rules around the conversion to RRIFs, for instance. All other Canadians have to abide by those rules, which are more restrictive than the rules that exist for small businesses.

Also, for small business use you are allowed much more flexibility in terms of how much money you can put in. You don't have to abide by the RRIF rules. You don't have to abide by contribution limits on RRSPs and TFSAs, which at present are a maximum of $31,000 a year. That is a lot of retirement savings.

Only 12% of private sector employees have a pension, so I'm glad small businesses are concerned about pensions, but it's not just an issue for small businesses. It's an issue for all Canadians.

Let me leave it there.

● (0925)

[Translation]

Mr. Alexandre Boulerice: Mr. Poitras, in certain regions, physicians are having a strong reaction. They say that they were urged to incorporate, and that now we want to change the rules of the game when they have become used to this tax structure.

Moreover, certain nurses’ associations say that it might be time for doctors to have a regime comparable to theirs, since they work in the same offices, but are not taxed in the same way.

How do you view this situation? How could we make these changes?

Prof. Stéphane Poitras: The health care system represents 40% to 45% of costs at this time. Fortunately, this rate is no longer increasing and has stabilized. That percentage, however, only takes public expenditures into account. If you add to that the tax advantages given to incorporated companies, this translates into enormous amounts. They have increased exponentially over the past years.

This is now a political choice. The issue is probably more of a provincial matter. We have to ask ourselves where we need to invest to get the best return on investments in the health care system.

As for physicians, we hear about many benefits. Certain physicians prefer to have benefits rather than to incorporate.

We know that most associations offer a type of bulk purchase of benefits at very low rate, because that population is relatively healthy. They have a lot of benefits such as disability insurance, wage-loss insurance, life insurance and so on.

Overall, this remains a political choice.

[English]

The Chair: Thank you.

Mr. Sorbara.

Mr. Francesco Sorbara (Vaughan—Woodbridge, Lib.): Thank you, Mr. Chair.

[Translation]

Welcome, everyone.
We will have been having this discussion for almost 75 days when it comes to an end on October 2, and it has brought forward a lot of good ideas. As well, tax fairness is something that was in our platform, something we ran on, and something that needs to happen. We want to avoid any unintended consequences. We want to ensure we do it right. That's why we are consulting, and we encourage everyone to submit their briefs in due time.

When I think of it, there are a lot of good things happening in our economy at this time. We have a very low unemployment rate, we've had a lot of good job creation, and we're going to lead the OECD this year, so we're on a very strong footing. Tax reform, or tax fairness, is something we need to do.

I have a question, and I'll start with Mr. Goulet.

Mr. Goulet, thank you for your discussion. How do we ensure that private businesses and private corporations that are generating capital—and we have very low tax rates, so they are generating a lot of cash—are investing that money back into the economy and, for example, not just putting it in passive investments? We can quibble about the definition of passive investments, but are they investing that money back into the Canadian economy?

[Translation]

Prof. Guy Goulet: Thank you for the question, Mr. Sorbara.

What you are proposing, that is to say not taxing income, is one way of doing things. The same tax rate would apply, and there would only be additional tax, which would not be returned, when the money is taken out of the corporation. That is when you see tax rates of 72% or 73%. That is one way of doing it.

Here's another way: let's say the low income tax rate would only apply if you reinvested those funds, otherwise you would be subject to the general tax rate. All of this complicates the Income Tax Act, because it is more difficult for SMEs to comply. There is always a cost to pay. You have to chose between simplicity and fairness.

You could also set a threshold. If you want to target the richer group, you could set the first tranche at $500,000 of invested capital in passive income, and it would not be affected by the rules. The $500,000 is equivalent to the maximum amount of business generated that allows a corporation to benefit from the lower tax rate. That figure could be a guide.

● (0930)

[Translation]

Mr. Francesco Sorbara: Thank you, Mr. Goulet.

Mr. Merrigan, the TOSI rules already apply—kiddie tax, if you want to call it that—to income, so this would be extending the TOSI rules to dividends. If your child—son or daughter to use better terminology—is working on the family farm, as the gentleman from New Brunswick so eloquently put it... We love those farmers and we want them producing food for Canada and becoming an agricultural leader in the world, which we basically are. But if your child is still working on the family farm or the family business, a restaurant maybe, we can quibble about what reasonableness is and how else you're able to interpret that, but let's assume that we can overcome that hurdle and we avoid those unintended consequences, effectively what we are doing is only extending the rules onto dividends where there are no rules on dividends right now, and basically where there is a preferential tax treatment. Some may call it an advantage, but I'm not going to use rhetoric this morning. I'm just going to say that there is preferential tax treatment on dividends for that 18 to 24 cohort versus where it is on income.

Is that not correct, and is that not something we can actually fix and is the right thing to fix, without getting into any unintended consequences of having some CRA officer come into the family farm and say what is continuous, what is reasonable, and all that, putting that aside?

Mr. Merrigan and Mr. Macdonald. Ms. Lahey, you can jump in too. I think you were nodding.

The Chair: You'll have to jump in fast.

Mr. James Merrigan: I'll step off quickly.

The problem with that approach, again, is that you're applying a different test to a family member than to an arm's-length person. That is where the TOSI rules become problematic as a tool for achieving this policy outcome. It's attractive, because on the surface it looks very simple and straightforward, but the implementation of extending the TOSI rules impacts all family businesses. That's why I don't think that the TOSI is the way. I think you need to do this in detailed regulation to set out thresholds, as my colleague Mr. Goulet suggested would be a good approach.

Mr. Francesco Sorbara: Could we go to Mr. Macdonald and then finally to Ms. Lahey?

Thank you.

Mr. David Macdonald: It's certainly true that the reasonableness test is not new. In fact, it already applies to salaries and fees, so there's a long experience in CRA. In fact, it's not a particularly arduous process. CRA provides a lot of flexibilities to families in terms of salaries and fee payments. The idea that CRA auditors are going to go down to people's businesses and check to see if they're doing three hours of work versus four is ridiculous. That's not actually what happens.

Extending that same rule on the dividend side takes a rule that's well understood and applies it to a different type of income, which is going to be the dividend income. I think from that perspective, the idea that people working on a family farm somehow will never be able to receive dividends, and if your mother and father work at the restaurant they would be forced into one person's hands, is scaremongering frankly. That's very unlikely to happen. Since it doesn't happen on the salary side, there's no reason to think it's going to happen on the dividend side.

Prof. Kathleen Lahey: I would agree, but there are two problems here. The first is that the reasonableness test is really well litigated and will work in this situation, but it basically then buys the change in justification for the small business corporation rules in the first place, and says that they're intended to provide educational funding, retirement plans, and so on.
The second thing is that the reasonableness test will no doubt reflect the existing nearly 28% income gap between what women are reasonably considered to earn on average in this society versus men. It would build in a lot of gender differences in a very unintended way, in a way that is still being litigated in the courts today with respect to people being hired to work in unincorporated businesses.

**The Chair:** Thank you. We went a little over there.

Mr. Albas.

**Mr. Dan Albas (Central Okanagan—Similkameen—Nicola, CPC):** Thank you, Mr. Chair.

I'm shaking my head because, first of all, the TOSI rules have been well established. The government says, in its own consultation paper, that it just isn't winning at court enough. When we talk about the reasonableness test, that's usually used in tort law and that's usually used in criminal law.

You're a lawyer, Mr. Merrigan. Who decides what is reasonable? A reasonableness test usually indicates someone of average skill and judgment within a certain situation. Is that correct?

*(0935)*

**Mr. James Merrigan:** Yes, but I'll point you in another direction. One of the consequences of this approach to TOSI is that a married couple will be able to income-split upon divorce, and a spouse can be compensated for her contribution in the business better upon divorce.

That will vary by jurisdiction. For instance, in New Brunswick they have a test that considers the contributions of the spouse at home. That has its antecedents in some very strong feminist legal theory to say that this enables a woman to be compensated for valuable work that enables the man to earn money. Fortunately, we're at a point where I have a colleague whose husband hopes to stay home and raise their children when that time comes. But you will be better able to income-split and divide the business, with less oversight and with more generosity, upon divorce. In New Brunswick the home contribution is considered. In Newfoundland it is not, so in Newfoundland the reasonableness test that is applied in the examination of your contribution to the business does not consider contributions at home. It considers strictly contributions to the business.

Therefore, you're going to ingrain a two-tiered system and you're going to create an economic incentive towards separation of the family unit in order to achieve... Do I think people will do this? Some people will—not many, but if you're on the cusp under economic distress, it is something that will be considered.

**Mr. Dan Albas:** Again, if this ends up being where a lot of these decisions will be decided at court...because it will be the courts who determine what's reasonable, not CRA. I don't think it's scaremongering to say that CRA will do its due diligence if it's going to contest something in court, and it will document why it believes something is unreasonable.

Would you agree with that, Mr. Merrigan?

**Mr. James Merrigan:** I would agree with that. I would also say that if you're a small business owner, the uncertainty of the harvest is one thing. The uncertainty when you're deciding how much to pay to your spouse or child for their work on the farm, knowing that in four or five years you could be spending money on litigation to determine whether it should have been $20,000 or $50,000, is a level of uncertainty that is not helpful to a small business person.

**Mr. Dan Albas:** I want to quote someone prominent in the government. The gentleman said this in Kelowna, “Speaking of tax changes, I want to be clear. People who make $50,000 a year should not pay higher taxes than people who make $250,000 a year.”

Mr. Goulet, Mr. Merrigan, I would like to hear your thoughts. Would this scenario happen?

**Mr. James Merrigan:** No, but somebody getting stock options of $250,000 would pay the same taxes, or less, as somebody making $125,000. The $50,000-$250,000 is not possible. The only way that would happen is if we compared stock options to CCPC or to an employment income.

**Mr. Dan Albas:** Again, the changes that are presented in the tax planning document do not include that.

**Mr. James Merrigan:** No, not at all.

**Mr. Dan Albas:** Mr. Goulet?

**Prof. Guy Goulet:** It's the same thing: no.

**Mr. Dan Albas:** Well, it's... That comes from two people who are well versed in this.

Mr. Merrigan, you mentioned your personal experience dealing with your legal community in terms of what these tax changes are already doing in Newfoundland. Could you elaborate a little bit more on that?

**Mr. James Merrigan:** Sure. I had a client who contacted me in June and wanted me to review a franchise agreement. The intention of the client was to take capital that had accumulated in one business and use it to invest in a franchise. The intention was that the second generation would own the franchise and the capital contribution would come from the parent.

I was contacted in July and asked whether I'd done the review yet. I told the client, no, I hadn't started it yet. They told me not to bother doing it. They'd looked at it, and when they saw the potential consequences of the investment, they didn't see a benefit to their children through investing in this business. They didn't see a benefit to themselves in terms of the return, because it could be treated as passive income. They didn't want me to look at it anymore. They were not investing. I've had other circumstances where people said that in this climate of uncertainty, at this moment, they were not making investment decisions. They were taking very conservative approaches to how they handled their capital.

Accountants are beginning prospective planning on scenarios, but basically, at this point, a certain portion of the capital that normally would be being invested has stopped moving. The investments are just not being made.

**Mr. Dan Albas:** We are at the lowest levels of investment in this country since the early eighties. If the government is trying to attract more foreign direct investment to this country... It was pointed out, by someone who is directly involved with trying to woo international investors, that it is becoming increasingly difficult, because if Canadian entrepreneurs will not invest in their own communities, why would someone else want to?
Do you feel that this is a growing sentiment in Newfoundland and other Atlantic provinces, which will only get worse?

**Mr. James Merrigan**: I can't speak to international investment. I don't deal with a lot of international clients coming into Newfoundland. I've probably had two in the last five years. What I can say is that the sense of the local small business community is that they are stopping investments at this point and waiting to see what happens. They are going to wait and see how this unfolds. When this legislation comes into place, they are going to watch and see how it actually works out before they do anything.

Unfortunately, the flow of capital at this point has slowed, and I don't see it speeding up until we have some very clear resolution of this.

**The Chair**: Thank you.

Thank you, all.

**Ms. Jennifer O'Connell (Pickering—Uxbridge, Lib.):** Thank you.

First, I want to thank Mr. Macdonald for his study. I referred to it yesterday in some testimony, so thank you. I may not have time to ask you a question, but I wanted to say how much I appreciated having some data to back up and get away from some of the rhetoric and personal stories of "I know a woman in business". That's some of the testimony we've heard, so I really appreciate this.

Professor Lahey, I really appreciate your testimony. It was almost like a history lesson in terms of where the proposals came from and how they were intended. You've laid out a really interesting approach, but I think there are some misperceptions, or maybe we are hearing what we want to hear. What I am hearing is you saying that the system was being used in a way that really encouraged women to stay home and receive dividends, in terms of part of the rhetoric and personal stories of "I know a woman in business". That's some of the testimony we've heard, so I really appreciate this.

Then, I hear comments from Mr. Merrigan saying that women should have the home contributions while the man earns the income, not to encourage breaking up the family unit. I don't think you meant that to be offensive, but I take it as a very offensive kind of approach to women in the workforce.

Professor Lahey, if I understand you correctly, you are saying that the way the system has been, it has actually encouraged the gender gap in income levels, and we shouldn't continue encouraging that gender gap. We shouldn't continue to have men earn the income and women stay home and be sprinkled income. What we should do is acknowledge the fact that the system has been established and there are people who will be affected by it—hence why we are not being retroactive, and that's what the minister has stated—but moving forward, we should not encourage a system where women earn 28% less than men.

Did I clarify the inequality in the current system and why we should not continue to have that, moving forward?

**Prof. Kathleen Lahey**: Yes, that's true. I think that is a good summary. The fundamental problem that women in Canada face is that they have not been able to close one of the biggest income gaps in the OECD. The biggest barrier really is this insistence that everyone should raise their own children personally and privately and for many years, which always detracts from women's long-term income-earning capacities overall.

When you add into the mix a system that is designed to think of family businesses as replicating and depending upon historical traditional male-female roles in the family, regardless of the gender and sexual orientation of the individuals involved, it incentivizes withdrawal from the support systems that exist.

To give an example, if the retirement income is dividends coming out of the corporation, then the women involved have no entitlement to GIS if there is a low income or to OAS, because their qualification space will be used up by the dividend income, which may not in some situations even be their income. That's the other problem.

The divorce and separation situation is quite different because from an equitable perspective any spouse does accumulate equitable rights in property that is produced in the matrimonial estate. That sits somewhat uncomfortably with what we're talking about here because there are some more traditional sectors of the economy than others. One of them is agriculture; another could be fishing. I think it is important to get the kind of data that is needed to scrutinize this. The data on where women are located in the economy has suffered badly over the last 20 years. It is not what it used to be. It needs to be ramped up and more information on women's economic situation needs to be brought into this discussion.

This can go forward, but it needs to be with a great deal of focus on how people are differently situated. I'm also talking about people who may not be in the highly paid professional careers, who may be more engaged in business because they can't get paid work in the employment sector, and who therefore are de facto running businesses, and may have been talked into forming a corporation because they're thinking they'll do better, but they have to withdraw all they earn because they can't live on their profits.

**Ms. Jennifer O'Connell**: Thank you.

**The Chair**: Sorry, Jen, we're quite over time.

**Mr. Kmiec**: Thank you all for being here.

**Mr. Tom Kmiec (Calgary Shepard, CPC)**: Thank you for the work you do. You'd probably rather be out managing your business than being in front of the Standing Committee on Finance and having to talk to all of us here.

We've heard the government repeatedly say that these changes are not retroactive, and then we've had experts from the Canadian Tax Foundation say the opposite. Their own proposal is retroactive. It's retroactive on estates and on those who are trying to transfer the family farm, especially from one generation to the next.
When you're operating your business, when you're planning for the future, obviously you talk to other farmers in your area, people in the same line of business, families who have been in this business for generations. What are they saying? People in New Brunswick who are in this type of business, planning for the future with their children, with their families, what do they think of these changes?

Mr. Andrew Lovell: They are upset. They are scared. There is one farm close to me that is seventh generation. The original land grants were made in 1784. Why would it be cheaper, or why would the government want less taxes on a transfer if he sells it to me, as a non-family member, as compared with his own children taking it over?

When we look at farm transfers, farming is a lifestyle. It's a lifestyle choice. I am an anomaly. I didn't grow up in a farming household. My dad worked at Sears. He's now losing his pension. For me, it's that tie to the land that is so important, because you're not going to get the typical person who didn't grow up farming to come and jump into a farming operation. That’s not going to happen. When we start looking at farm operators, the average age of the Canadian farmer is 52 or 55 or something like that, and if we see a slowdown in farm succession, where are we going to be in 10 years when those farmers want to retire and all of a sudden that guy has to pay double the tax? We're either going to see an outside corporation buy it—we've already seen many international farms buying farms on the Prairies—or we're just going to see farmland abandoned.

Just for interest, there are 167 million acres of farmland in Canada and, according to the last census, every one of those acres generated $646 per year. If the average farm size is 728 acres, that means every one of those farms is generating $470,000 of GDP every year. What happens if we start losing them? What is the plan?

In New Brunswick there are 117,000 acres of vacant farmland. When we apply those numbers to it, that means New Brunswick's GDP is short $75.5 million a year because, somewhere in history, those farms have not gone through succession and that land is now sitting there vacant. How is this good for Canadians? How is this good for our society?

I don't understand.

(0950)

Mr. Tom Kmiec: Thank you, Mr. Lovell.

[Translation]

Professor Goulet, you said that there would certainly be collateral damage. Could you describe some of this collateral damage?

Prof. Guy Goulet: Thank you for your question.

As I explained, we hear less about the third category of measures because their purpose is to block aggressive tax planning. There is a proposal to amend section 84.1 of the Income Tax Act and to create section 246.1, which is an anti-surplus stripping rule. This will cover aggressive tax planning, regarding which we lost the courts. When I say “we”, I am talking about the government. I apologize, I still have reflexes that go back to my work at the CRA. However, the scope of these amendments is somewhat broad.

The amendment to section 84.1 is going to eliminate one type of planning that was used, which we called the pipeline type, and which allowed people to avoid double taxation when an entrepreneur died. When a person dies, they are deemed to have disposed of their assets. The deceased shareholder thus has made capital gains on his or her shares, and the shares are passed on to the estate. If you decide to wind up a corporation, you then have a dividend. So there are two potential taxes. There would be ways of correcting that, of refining the act in order to block undesirable transactions, while bringing in measures to avoid the dual taxation of the estate of the deceased.

With regard to proposed section 246.1, this is a very broad rule that would apply as of July 18, 2017, on paid-out dividends. It may be that transactions done before July 18 by a corporation that generated capital gains were a part of tax planning and were done in good faith. However, people are now getting caught for having breached that rule. It might be a good idea to adopt an interim rule to cover those situations.

[English]

The Chair: Thank you both.

We're quite a bit over, Tom, so we'll have the last member for this panel, Mr. Grewal.

Mr. Raj Grewal (Brampton East, Lib.): Thank you, Mr. Chair. Thank you to the witnesses for attending today, and we thank you so much for your testimony.

I just want to make it very clear that our government recognizes that farms are unique businesses and hold a very special place and all families who farm. As a son of a farmer, whose grandfather was also a farmer back in Punjab, I understand the hard work that it takes to operate a farm. We really will be focusing, and we're taking a lot of feedback from people testifying on farms, to make sure that there are no unintended consequences of the tax proposals. So thank you for your testimony. We really appreciate the feedback.

My questions are to James.

Thank you so much for your testimony today. You focused a lot on income sprinkling and unfairness. I think there are a lot of misconceptions, and I want to highlight the fact that it's a proposal. The purpose of developing good policy is to talk to Canadians and experts, to get their feedback, and then to go back to the table and draft something that achieves the balance of a more level playing field in the Income Tax Act.

Would you not agree that, like Mr. Macdonald said, you'll still be able to sprinkle your income among your family members, as long as you can prove that they contribute to the corporation?

Mr. James Merrigan: That's a rather unique perspective on a share. I have mutual funds. I have shares in Coca-Cola. I've never set foot on the floor and I'm entitled to a dividend by means of ownership. Where that really meets the ground is when families invest in families' companies.
I have clients who are brothers. These brothers both invested in a company. One of them was very interested in running it, the other not so much. About 10 or 15 years ago one of them ceased to be active in the company. He owns half of it. He draws down the dividends.

Two things are going to happen to them under these TOSI rules, and they're quite concerned about them. The inactive brother has been receiving dividends for the last 10 or 12 years, equivalent to the active brother because they're fifty-fifty shareholders. That history will now be used, under the reasonableness rules, to say he has been unreasonably compensated historically because that's one of the three prongs in the reasonableness test. Second, he's not contributed any labour. Third, the initial capital for both of them was quite modest, so he didn't contribute a lot of capital—certainly no more than the other. He's owned half of this business for a long period of time, and under these new rules he will be taxed as if he were making $220,000 a year on any dividends he takes out, yet nothing will have changed in the business.

If he were an arm's-length shareholder, that would be completely unaffected by these rules. The reality is that families start businesses and they occupy different roles, and they set it up the same way as people at arm's-length. Now, under the proposed TOSI rules, those types of family companies will be treated in a very different fashion. Going forward, families will be discouraged from investing in family businesses by these rules.

Mr. Raj Grewal: Just to clarify, you're saying that an arm's-length investor would be able to continue as the rules are today, but a related party investor would be subject to the new rules.

Mr. James Merrigan: Correct.

Mr. Raj Grewal: You're saying that there's an unintended consequence of being a related party investor.

Mr. James Merrigan: Absolutely correct.

Mr. Raj Grewal: Okay, so then in the example of a husband and wife who operate a small family business, where the wife works part time, that would be still okay under the new rules.

Mr. James Merrigan: It would, but where it gets complicated is a very typical—

Mr. Raj Grewal: Everything in tax policy is complicated. There's no doubt about that.

Mr. James Merrigan: A very typical situation, and one to respond to your colleague's concerns, is that there are more female graduates from medical school now than men. Women are asking their spouses to stay home, and they're using this income-splitting device to enable them to have a family and to continue to practise medicine.

Mr. Raj Grewal: Yes, without a direct contribution to the corporation.

Mr. James Merrigan: Without a direct contribution, except that—and this is quite common—one spouse attends medical school while the other one works. During the medical school years the husband is supporting the wife. When she graduates and establishes her practice, they decide they're going to have a family. She has to take some time off. Money up in the company will support that leave. Then—and this is very common now—he will stay home with the children but be drawing a dividend from the company. He has unquestionably contributed to her ability to earn income by supporting her through medical school and by taking on child care duties. That contribution will be treated differently from a capital investment.

The other thing I would point out—

Mr. Raj Grewal: We're about to hear from the Canadian Medical Association, so I'll let them get into it.

Mr. James Merrigan: I have another comment.

Mr. Raj Grewal: Sorry, I don't mean to cut you off, but you made a comment that I respectfully disagree with, namely, that our rules are going to encourage people to split their families.

Mr. James Merrigan: That's not going to happen.

Mr. Raj Grewal: But you did say that, right? I want to say that, as Mr. Macdonald said today, this notion is very far from the truth. That is pushing an element of fearmongering on these tax proposals, and it's un-Canadian, in my humble opinion.

As a fellow lawyer and member of the bar, I think we owe a duty of care to the Canadian public to judge the proposals on their merits. When you speak to people, I would caution you not to make irrational assumptions about the proposed tax changes.

The Chair: We'll let Mr. Merrigan clarify that point and then we'll have the—

Mr. Raj Grewal: He made the statement. He said—

The Chair: Order.

Mr. Merrigan, do you want to clarify?

Mr. James Merrigan: I'm happy to clarify that.

The Chair: Order, please.

Mr. Merrigan.

Mr. James Merrigan: My statement was that there is an economic incentive here. In other words, the family unit could be financially better off in the case of a separation. I've done divorce law. I've sat with couples, with wives and with husbands, and when they get down to making this difficult decision, they consider the economics.

Do I think that a family will say they're not interested in a divorce, but they're going to separate for the economic advantage? No, I do not. Do I think there is an economic incentive? Yes, I do. Will that be weighed in the analysis in borderline cases by families considering their options? Yes, it will. Is that the same as saying that you're trying to break couples up? No, it is not.

One of the unintended consequences, however, is that you create this economic incentive.

Mr. Raj Grewal: Thank you for the clarification.
The Chair: Mr. Grewal stated that this is a proposal, and I think we all know that we're in consultations until October 2.

I heard you, Mr. Merrigan, and some others have said we should simply define it as a “flight of capital”. That's worrisome. We are dealing with proposals on the table and we are in consultations. How critical is it for the government, fairly rapidly after October 2, to bring clarity to where it's going to stand going forward?

I've heard people say to extend the consultations. I'm personally not in favour of that, even though I know farmers need more time. I do think, though, that the government has to bring clarity to the issue. What are your thoughts?

Mr. James Merrigan: I think that the question of unintended consequences should have been dealt with up front. I think that detailed provisions to deal with the unintended consequences, which have been amply identified, need to be brought forward. There needs to be consultation on those. As we've seen in this kind of fractal approach to tax law, one consequence begets another consequence. It's a very old and complex tax system, and incremental changes with unexpected consequences will require more consideration rather than less.

The Chair: Mr. Goulet, and then we'll have to adjourn.

[Translation]

Prof. Guy Goulet: I simply want to say, as to the first and last measures, that that could be done quite quickly. However, as to the passive investments, I think that we have more time since there are no defined rules as such. There could perhaps be another step, either a consultation or a more defined project.

Thank you.

[English]

The Chair: That's helpful. My thanks again to the witnesses for their presentations, and for responding to members' questions.

The meeting is suspended.

* (1000)  

(The Chair continues:)

The Chair: We'll do a pretty hard stop at about 11:25, if we could, because the minister will be on at 11:30.

Just for the record, pursuant to Standing Order 108(2), the committee is doing a study of tax planning using private corporations, and what is presented before this committee during this panel will be forwarded as part of the consultations by the Department of Finance on the tax planning issue.

Welcome to the witnesses, and thank you for coming, many of you on short notice. We'll start with the Canadian Federation of Independent Grocers, Mr. Sands, senior vice-president.

Go ahead, Gary, and welcome.

Mr. Gary Sands (Chair, Small Business Coalition, and Senior Vice-President, Canadian Federation of Independent Grocers): Thank you, Mr. Chair.

Good morning. I want to thank the committee for the invitation to appear today and participate in the discussion as part of the consultation on the government's current review of tax planning using private corporations.

While I am the senior vice-president of the Canadian Federation of Independent Grocers, I am speaking today in my capacity as chair of the Small Business Matters coalition, a group of trade associations covering a wide variety of sectors. The cumulative number of businesses we represent is about 180,000. In terms of a coalition size, we are now the largest in Canada.

Over the last few weeks, there's been a lot of sound and fury coming forth from various quarters on the proposal about the issue we are discussing today and how the current system may not be working for the purposes intended.

Our coalition was aware that, in the last federal election, the Liberal Party had declared in its policy platform that, if elected, they would move to reduce the current small business tax rate to 9% but wanted to “ensure that Canadian-Controlled Private Corporation (CCPC) status is not used to reduce personal income tax obligations for high-income earners rather than supporting small businesses.”

During the course of the last election campaign, our coalition supported that plank. I believe that was reiterated in the Minister of Small Business's mandate letter that was publicly released.

I went through the media clippings before I came here today, and I can't recall seeing any outrage or anything like the sound and fury that we're seeing today. But as we said to the minister, we reiterated our support for the principle behind that review, a review aimed, as we understand, at exploring ways to ensure there was fairness and more transparency in the current system, and that it is being utilized by genuine small businesses for the purposes intended.

We also said to this minister, to this committee, and to previous ministers, as did others in the business community, that we need more fairness and transparency in the payment system in this country that is currently allowing small businesses to be put at a competitive disadvantage by unacceptably high credit card interchange fees amounting in the billions of dollars. The concept that you could push forward support for these principles in one area but not in another leaves me personally perplexed.

I'm not saying, and our coalition is not saying, that some changes cannot be made to proposals that were outlined in the consultation document. I expect changes will be made by the government based on the input they've received. The government has made clear to us that they are listening during the consultation period, and we have yet to see any legislation on the most contentious piece, passive income, nor any definitive statements of finality by the government as to how they intend to proceed.
When this occurs, we will make our views known, but in the context of this review, let's apply that principle of fairness and transparency to income sprinkling as an example. This is an extremely important measure that exists to compensate family members making a reasonable contribution to the business, and we look forward to working with the government on defining that term. But income sprinkling should not be used as a means by which self-employed, high-income professionals avoid tax by sprinkling income among family members with no reasonable connection to the business.

I know people who take advantage of this tax planning strategy, but with all respect, as I have said to them, the money that is going to them, our coalition believes, should instead be used to help further reduce the small business tax rate. Notwithstanding that Canada has the lowest small business tax rate in the G7, our small businesses have unique cost challenges. While investing in the bricks and mortar of their businesses, hiring local, buying local, and being the backbone of communities across this country, our members cope with skyrocketing energy costs, higher credit card fees for small businesses as opposed to large corporate chains, the growth of online shopping, and in some provinces, whopping minimum wage increases and a myriad of various and increasing fees, charges, and premiums.

All of these costs and more have a disproportionately deeper impact on small business. All too often this context is forgotten when governments examine the small business tax rate. All three levels of government must do more to be cognizant of the cumulative impact of these costs, no matter what level of government is responsible.

At the same time, the business community must be consistent when it pushes government for more fairness and transparency in other areas. We must ensure that the tax system is one that continues to support small businesses' ability to invest, hire more people, source Canadian products, and to expand. If the review that has been undertaken allows Canada to build on that, this is something, again, our coalition supports.

If there is one message I would leave with this committee today, it is to convey to them that, no, the entire small business community is not lighting their hair on fire over this consultation. Our members understand the principles that are being discussed in this review. We feel we are being listened to, and thanks to the openness that we have personally encountered with Minister Morneau and others, and how they've dealt with us—and that's all I can speak to—we're confident that the government will take action to ensure there are no unintended consequences to these proposals.

And yes, I want to repeat that we want to see a further reduction in the small business tax rate.

Thank you.

The Chair: Thank you, Mr. Sands.

Just for committee's information, on the witness list is the Dairy Farmers of Canada. The individual representing them, Mr. Dykstra, was to be on a flight out of Toronto that got cancelled. We do have their brief and it will be translated and presented to committee members.

The representative, Mr. Lammam, from the Fraser Institute, who's in Vancouver, was supposed to be on video conference but that didn't work, so he is listening and will present by teleconference.

We'll turn to Mr. Roberts with the Canadian Labour Congress.

The floor is yours, Mr. Roberts.

Mr. Chris Roberts (Director, Social and Economic Policy, Canadian Labour Congress): Thank you, Chair.

Good morning, committee members. Thank you very much for the opportunity to appear before you today. I'm here on behalf of the Canadian Labour Congress.

The CLC is Canada's largest labour central. It's the voice on national issues for 3.3 million working people in Canada and brings together national and international unions, provincial and territorial federations of labour, and more than 100 district labour councils from coast to coast to coast.

I am the director of the social and economic policy department of the CLC, but I'm not a tax expert. I'm here this morning to convey the CLC's support for the government's steps to address tax planning through Canadian-controlled private corporations.

The CLC welcomes the federal government's plan to close tax loopholes for very high income earners. In our view, this tax proposal is an important first step towards bringing greater fairness to Canada's tax system. Current tax rules surrounding CCPCs make it possible for someone earning $300,000 to save more on their taxes than the average Canadian worker makes in a year, and that is fundamentally unfair. There is strong evidence that the benefits of preferential tax treatment for CCPCs accrue disproportionately to a select group of high-income families.

According to the Department of Finance, two-thirds of the top 0.01% of income earners own a CCPC. Published research by Professor Michael Wolfson found that more than 70% of those in the top 0.01% with incomes over $2.3 million owned a CCPC, and nearly half of individuals in the top 1% did. These numbers compare with fewer than 5% of taxfilers in the bottom 50% of the income ladder owning a private company of this sort. Those are 2011 figures. Among the bottom 90% of income earners, fewer than 10% had a CCPC. Moreover, a portion of those individuals who owned shares in a CCPC would be low-earning spouses of high-income earners and therefore be from high income-earning families.

I want to stress that these tax planning opportunities are generally not available to working people. To incorporate is a complex undertaking entailing not insignificant costs, particularly when multiple CCPCs are formed by a single individual. The ability to benefit disproportionately from the tax advantages of incorporation increases at higher income levels.
The number of CCPCs has increased by 600,000 in the last decade and a half, a 50% jump. This kind of tax planning is costing the federal government approximately $500 million a year or more.

Taxes pay for the vital services that we all rely on, from physical security and food safety to health care and education and disaster relief. Canadians expect everyone to pay their fair share. Our tax system currently generously rewards those who take on business risk. Canada has the lowest small business tax rate in the G7 and is described by KPMG as being the most tax-competitive country for business globally. Preferential tax treatment for CCPCs allows individual investors to reinvest in their businesses at a reduced rate of taxation, and business owners are able to claim tax deductions on their business expenses.

We therefore support the government’s steps to address tax planning through private corporations, but in our view reforms can’t end here. After a decade and a half of aggressive corporate income tax cuts at the federal and provincial levels and increasingly favourable terms for small businesses, we need to ensure that top income earners and are beyond the reach of the vast majority of wage and salary earners in this country. Their benefits go disproportionately to a small group of high-income earners and are beyond the reach of the vast majority of wage and salary earners in this country.

In closing, we hope that the 2018 budget and the government's legislative proposals coming out of this consultation will take on some of the most regressive, wasteful tax breaks as well as tax planning opportunities through private corporations, tax favours whose benefits go disproportionately to a small group of high-income earners and are beyond the reach of the vast majority of wage and salary earners in this country.

Thank you very much.

The Chair: Thank you very much, Mr. Roberts.

Turning then to the Canadian Medical Association, we have Mr. Marcoux, president, and Mr. Feeley, vice-president of member relevance.

Welcome. The floor is yours.

Dr. Laurent Marcoux (President, Canadian Medical Association): Thank you, Mr. Chairman.

The CMA and our 85,000 members are proud to empower and engage with our patients, and to provide the highest quality of health care for Canadians.

[Translation]

Like many other organizations representing small businesses in Canada, the CMA remains seriously concerned about the magnitude of the proposed amendments and the time frame for a detailed evaluation of the impact of the proposals. We believe that 75 days for consultation is not enough, given the scope of the proposed changes to a structure that has existed for 45 years.

I would like to address three major issues that set out the unexpected consequences of the tax proposal as presented.

First of all, what happened to promoting the health of the economy?

You heard from the Coalition for Small Business Tax Fairness that small and medium businesses are the economic drivers of Canada. This description also applies to doctors’ offices because they generate significant economic activities, while providing essential medical care to the communities that make up our great country.

It is becoming imperative to maintain the conditions needed to support the continued success of doctors’ offices when the growth of the economy and the delivery of essential services are taken into account.

Here are some facts about it. In 2016, for instance, the gross domestic product generated directly by doctors' offices in Canada reached $22.3 billion. Medical professionals paid $6.2 billion in salaries and employed 137,000 people. Doctors' offices have generated $643 million in tax revenue for government coffers.

The tax proposals under review require doctors whose practices are incorporated, like any entrepreneur, to adjust their business models. These adjustments will have unexpected consequences by bringing about a decrease in the economic footprint of doctors’ offices and by potentially limiting services to Canadians.

Second, why is incorporation logical for so many doctors in Canada?

The majority of doctors, or 66%, for a total of 54,000 doctors, own and operate a private company that is the structure that supports the viability of their practice by providing access to working capital. Doctors rely on working capital to invest in their practice, which includes the purchase of equipment, modernization of examination rooms, implementation of electronic medical records, and many other clinical investments. Working capital is also essential when physicians seek to provide more services to meet the growing health care needs of the community.

The structure may also make funds available to compensate for maternity leaves, sick leaves, parental leaves and employee turnover, as well as to save for retirement.

As a legitimate business organization for doctors that has been endorsed and encouraged by successive governments, incorporation has well-established risks and benefits.

Lastly, why is it necessary to make the right decision at this point? That's the last and most important question.
Doctors' offices play an essential role by giving Canadians access to medical care across our vast country. Any change to the current tax system may have unexpected consequences by forcing owners of doctors' offices to decrease their activities and by stifling the expansion of the most needed medical services.

● (1025)

[English]

We have an opportunity to get this right, and Canadians want us to. The proposals announced in July have far-reaching implications and unintended consequences. As a result, we strongly urge the government to undertake a comprehensive review of the tax system, with fairness as the principle driver of change. A fair tax system accommodates taxpayers who assume different levels of risk, and is flexible enough to allow small business owners, including physicians who operate medical practices, to manage in various circumstances.

Finally, fairness also dictates that if self-funded safety net provisions are eliminated or significantly adjusted in the new tax regime, other vehicles must cover planned and unplanned events. In our submission to the government, the CMA will ask that the proposal be suspended to allow for a complete review of a tax system that engages all Canadians and considers the unique aspects of all sectors.

I would be happy to answer any questions you may have.

Thank you.

The Chair: Thank you very much, Mr. Marcoux.

Now we have the Fraser Institute by teleconference.

Mr. Charles Lammam (Director, Fiscal Studies, Fraser Institute): Thank you, Mr. Chairman and committee members, for the opportunity to offer my thoughts on the federal government's proposed tax changes affecting private corporations. I hope you find my comments helpful and informative as you deliberate on this important public policy issue.

I'm the director of fiscal studies at the Fraser Institute, an independent, non-partisan economic policy think tank. The institute's mission is to measure the impact of government policies and to broadly communicate to Canadians how those policies affect their lives and the lives of future generations. My comments today reflect my own opinions and observations. They do not, necessarily, reflect the views of other staff, affiliated researchers, or our board of directors.

Since the committee has already heard much about the technical aspects of the government's proposed changes, I will focus my remarks on points that I think have not received sufficient attention in the public debate.

First, I want to commend the government for undertaking a review of the tax code. Canada's personal income tax system has become increasingly complex and uncompetitive over the years, so the goal of reform is a positive one. In fact, the Fraser Institute has published studies on both the growth in tax complexity and the opportunity for the federal government to dramatically simplify the tax system while fostering economic growth. This was largely a response to the previous government's tax changes, which tended to increase the system's complexity with no material improvement in efficiency. As part of the current review, the government has correctly identified problems with our tax system, including a proliferation of so-called boutique tax credits, which are economically ineffective tax breaks for certain groups and individuals. In addition, it has identified tax planning through the use of private corporations as another problem area.

However, the policies implemented to date by the current federal government, including the elimination of several tax credits, along with the proposed changes to the taxation of private corporations, are best described as a piecemeal approach that falls short of the type of comprehensive tax reform that Canada now needs. This is a lost opportunity.

A major shortcoming of the government's approach to these tax changes is how it plans to use the expected revenues from eliminating preferential tax measures. The standard approach to tax reform, as was the case with Canada's major personal income tax reform in 1987, is to use the revenues from eliminating preferential tax measures to reduce marginal tax rates broadly. In doing so, the government would eliminate special preferences for certain groups while reducing tax rates for everyone, thus improving the economic environment for workers, business owners, entrepreneurs, and investors. Instead, the federal government plans to retain all the new revenues. This is actually a trend with the current government, as it has eliminated a number of tax credits and other special privileges embedded in the tax system without using the resulting revenues to cut rates broadly by an equivalent value.

When it comes to the proposed tax changes to private corporations, it's important to understand why anybody pursues tax planning through such vehicles in the first place, since doing so comes at a significant cost. Business owners, including professionals, must spend significant amounts of money on accountants and lawyers in order to use these options in the tax code. The reason these expenses make sense is that the costs are less than the benefits they gain by lowering their effective tax rates critically. The tax savings are a result of large gaps between different levels and types of income.

For instance, a professional can shift income to a spouse with lower earnings or perhaps a dependent child with no income. If the professional can do so, the gains from the lower tax rates can be significant. Let's assume a doctor being taxed at the top federal rate of 33% can shift income to a spouse who only works part time and pays income taxes at the lowest federal rate of 15%. That's an over 50% reduction in the marginal tax rate by shifting income from one spouse to another. The gain is even larger if the income is shifted to a dependent child with no income.
These tax differences are the reason why people pursue the strategies in question. If the government reduced the gaps between tax rates, it would reduce the incentives, i.e., the benefits, of such tax planning in the first place. Instead, the current government has made this gap larger by increasing the top federal tax rate from 29% to 33%.

By making the tax gap larger, the federal government, along with several provinces, inadvertently increased the incentive for eligible professionals and business owners to use these strategies. Introducing new rules alone to eliminate or mitigate the use of these strategies, as the federal government now proposes to do, will not solve the underlying problem. They will simply incentivize accountants and lawyers to figure out new ways to get around the new rules for their clients. The solution is to concurrently eliminate, or at least meaningfully reduce, the tax rate differentials that exist in the system. Doing so will reduce the incentive for tax planning in the first place.

I have just two final points.

A risk inherent in the government's proposal is the potential to make the tax system more complicated without solving the fundamental problem. There will remain an incentive for Canadians to incur the cost of hiring accountants to help them tax plan, but the administrative and compliance costs will increase as the Canada Revenue Agency plays a greater role in enforcing the proposed new rules.

Finally, my last point relates to the negative signals the government is sending entrepreneurs and investors in its public communications regarding the proposed changes to small business taxation. For instance, on a nationally televised interview, the finance minister used the phrase “going after” to describe his government's approach to extracting more taxes from incorporated professionals and wealthy people. This language signals to the world that Canada is an unfriendly place to do business, which undermines our country's ability to attract investment, which is a key ingredient for economic growth and innovation. Fortunately, we've seen positive tax reform from past federal Liberal governments, whether that's forging a technical committee on business taxation and implementing many of the committee's recommendations, or expanding RRSP contribution room, or lowering the inclusion rate for capital gains taxation. Indeed, pro-growth tax reform is a non-partisan issue.

Thank you, and that concludes my initial remarks.

The Chair: That's a great part of the country. It has the deepest topsoil, and very productive topsoil. I've been up there a lot.

Go ahead, Mr. Burello.

Mr. Eddy Burello (Partner, MNP LLP): Thank you very much, Mr. Chairman, committee members. Thank you very much for having us here this morning to provide evidence on the rules proposed on July 18 relating to the taxation of private corporations.

Kim and I are partners at MNP. MNP is the pre-eminent accounting, tax, and consulting firm to family businesses in Canada. We represent 150,000 private enterprises and family businesses, and 16,000 farmers. We're the primary service adviser to over 350 Hutterite colonies in Canada. We've heard from them.

They've clearly said they all agree that a tax reform is required, and fairness in a tax system is an honourable goal. We're not all convinced, though, that the proposed rules of July 18 achieve those objectives. They all concur that tax fairness with the simplicity of a system that can be administered is paramount in tax reform, and that tax reform takes time. Again, the July 18 rules probably don't achieve those two objectives.

Meet my other client, Marie. Marie recently transferred her farm business to her family after 30 years. She is now retired and receiving $40,000 on the redemption of her shares to fund her retirement obligations, taxes being one of those, around $1,000. Under the proposed tax on split income rules, the fact that Marie is no longer active in the business and has limited capital since the redemption means that tax will now become $16,000, a 16-fold increase. Marie doesn't think the July 18 rules are fair. She is not alone.

Our colleagues in Alberta look at the passive income rules as problematic. Our colleagues in Alberta had built up a liquidity chest to help fund the economic downturn they're currently facing. I was recently discussing with Kim, a client in our Calgary office, how, if it wasn't for that holding company, they would not be able to sustain their business operations today and continue to employ Canadians, given the downturn they're facing in Calgary. This is problematic.

The transfer of family businesses is also problematic. Family businesses today will face a bias. They would prefer to sell their businesses to an arm's-length third party because the effective tax rate is 25%. Selling intergenerationally to their family members may cost them twice as much. Tax should not be driving the decision as to who they want to sell their businesses to. If families want to continue their businesses, they should not be penalized by having to pay twice as much.
We all know death and taxes are inevitable. The earnings-stripping rules under sections 84.1 and 246.1 are problematic. You've heard from others, and you'll hear from us as well, that on death, private corporations should not be expected to pay twice as much. This affects all small businesses in Canada, not a niche or a small minority. All businesses, when their owners die owning those shares, will have a significant tax implications that need to be addressed.

We see the July 18 rules as a fundamental change to the taxation of private corporations. We don't disagree that tax reform is required. However, the rules proposed on July 18 are vague, uncertain, and lack predictability. Statutory interpretation requires that legislation be clear, fair, and predictable, so all Canadian taxpayers can plan their affairs accordingly. The proposed legislation is far from that.

We have ample evidence of where the vagueness in the language will cause uncertainty. Today, private corporations and their owners are pausing to understand what it means and how they can go forward. What do we recommend, you may ask?

Number one is, if we're going to undertake tax reform, we need a collaborative consultation period to involve all reasonable stakeholders. Open-minded stakeholders will all agree that tax reform is required in order to impose fairness, simplicity, and a certain level of equity for all Canadian taxpayers alike. The current rules lack those initiatives that we need to seek in the new rules.

I'd ask today that the consultation period be extended to incorporate more of these issues with the existing rules so that we can avoid these unintended consequences for all private corporations in Canada today.

Thank you. We look forward to your questions.

The Chair: Thank you very much, Mr. Burello.

As I pointed out before, it's legislation proposed on July 18, not legislation.

We're turning to Mr. Wolfson, professor, University of Ottawa, as an individual.

Professor Michael Wolfson (Professor, University of Ottawa, As an Individual): Good morning.

I'd like to thank the committee for the opportunity to comment on the Department of Finance proposals, and also thank the staff for their last-minute translation of the three tables and charts I'd like to use.

I would like to focus my remarks on two questions. Briefly, is income sprinkling unfair and how can we know? Do we have the evidence that Parliament and the people of Canada need?

You've already heard a lot about unfairness from most of your witnesses. Indeed, I'm heard that there seems to be almost unanimous agreement that there is an issue of fairness. To reinforce this point, the first table in the handout shows some calculations that were produced by a private sector tax consultancy. These figures compare the income taxes of an individual who receives their income simply as a salary, with an individual who receives exactly the same income but via a private company, and in the same year, pays it out as dividends to a spouse, or in one of the rows shown, to a spouse and two children, none of whom have any other income.

I'm guessing that the first row, at $73,000, was put there because of the claims made by Dan Kelly and the CFIB, and the group with which he's associated, that two-thirds of small businesses have incomes below $73,000. While not stated explicitly, the implication is that this group is going to be hit hard by the proposals.

If we focus on the income sprinkling part of the minister's proposals, a very large portion of these small businesses don't even have CCPCs, so they would be totally unaffected. Even if the small business were incorporated and did income sprinkling, their tax savings would likely be less than the cost of the tax planner's fees.

I'll skip over describing the other numbers. A few minutes ago, Chris Roberts described the figures, the statistics that are shown in the graph, where 90% of individuals, for example, had less than $68,800, and well under 10% were owners. Let me emphasize a point that he made, that some of these middle- and lower-income CCPC owners were likely the spouses and children of the main CCPC owner, so that in terms of their family income, they lived in families with much higher incomes.

In my last set of graphs I've shown the number of CCPCs from 2001 to 2011 in four provinces, for each of three industrial classifications: restaurants, lawyers, and doctors' offices. The number of restaurant CCPCs has been fairly stable, drifting up a bit, while lawyer CCPCs have increased quite steadily over this decade in all four of the provinces shown.

More dramatic though are the number of doctors' office CCPCs in Ontario. In 2005 the Ontario government, as part of its fee negotiations with the Ontario Medical Association, made an obscure change in their corporate law—page 159 of the budget—to enable family members of doctors and dentists to own shares in their private companies. This change may have been well-hidden from the general public, but it must have been of real benefit to doctors and their families' tax positions since the number of their CCPCs increased 10-fold in the following years.

The change in Ontario's corporate law enabled high-income doctors who set up CCPCs to save tens of thousands in income taxes, and likely had virtually no benefit in terms of real economic growth. In the context of what the Canadian Medical Association said, “Ideally, we wouldn't get sick”, so the expenditure or the contribution to GDP is considered by some economists of medical expenses as regrettable. You'd rather not have to fix people who get sick.
Using CCPCs for income sprinkling is unfair, both horizontally between individuals with the same income but able or unable to run this income through a company, and vertically by eroding the progressivity of Canada's income tax system. Rising income inequality has come to prominence over the past few years, with a focus on the income shares of the top 1%. Our analysis suggests that this degree of inequality is worse than the statistics indicate because these statistics fail to account for income received but retained within private companies.

When we pierced the corporate veil and added these hidden incomes to the share of the top 1% in 2011, it increased by one-third and by half for the top one-tenth of 1%.

Let me now turn briefly to my second and last point. The two graphs that I have just shown stop in 2011. When we started our research in 2013, this was the most recent data available. It took us over two years to assemble the data underlying these results. I'm very proud of the fact that our research has allowed us to shine a light, for the first time ever, into this dark corner of Canadian tax policy.

Unfortunately, such new light in the dark corners of the tax system is rare. As the Auditor General concluded in his spring 2015 report, tax-based expenditures “were not systematically evaluated and the information reported did not adequately support parliamentary oversight.”

While Parliament is able to scrutinize every dollar of what I'll call “front-door spending” by the government every year in the main estimates, various backdoor expenditures via tax preferences—or tax-based expenditures, as the AG calls them—are barely scrutinized once, when they are introduced in a budget.

Further—and let me conclude on this point—the analytical capacity of the federal government has been seriously eroded in the past decade. The previous government was notorious for knowing what it wanted to do, regardless of any evidence or analysis, especially when it was contrary. As a result, policy analysis groups within government departments have generally withered. It takes less than a year to destroy one of these groups, but up to a decade to recruit and rebuild. I worry that part of this government's initial communications problems with these finance proposals may be a reflection that, even the Department of Finance, for decades a powerhouse of unrivalled analytical expertise, has experienced some of this erosion as well.

Thank you.

The Chair: Thank you very much and I thank all the witnesses for their presentations—many on quite short notice.

Before we go to questions, for committee members, we have to deal with one technical issue. The normal policy of the committee is that nothing is distributed unless it's in both official languages. On this set of hearings, we have agreed that we will distribute the submissions to the minister's office in their original language. They have the capability of translating them there.

In terms of the committee members themselves though, is there a desire to distribute the briefs, so that they have them in their submissions to committee members as they come in or does the original rule stand? The minutes of the meetings are certainly translated. They'll be translated and come out. Are there any thoughts on that matter? If not, we will hold the submissions and they will be distributed to members when they are translated.

Yes, Mr. Boulcerie.

Mr. Alexandre Boulcerie: I think the current rules should remain and that the documents must be translated before they are distributed.

The Chair: That's fine. That's what we will do. I just wanted to clarify that matter because there are some questions on it.

We'll be turning to questions then. We'll go to solid five-minute rounds.

Go ahead, Mr. Grewal.

Mr. Raj Grewal: Thank you, Mr. Chair, and thank you to the witnesses for coming today.

I want to start off with Mr. Sands. We've heard a lot of feedback on the tax proposals, whether in the riding or here in Ottawa in the finance committee. It's actually great to see so many people come out and share their thoughts. I've mentioned this before and I'll mention it again. This is a great way to engage Canadians in developing better policy.

Some things that I think everybody can probably agree on is that the Income Tax Act needs to be more simple, more clear, and more predictable, so that we don't need lawyers or accountants to be hired anymore. If you are living in Canada, you should be able to understand the Income Tax Act. That's a really good take-away.

One thing I really appreciated from your testimony was that you gave a pretty good proposal on income sprinkling. You said that, if there is no reasonable contribution to the corporation, you shouldn't be able to sprinkle the income. I think a lot of Canadians would agree with that statement. You also emphasized that, just because we're changing that rule, it shouldn't mean we shouldn't help small businesses in another way, which is to reduce the small business tax rate. Can you comment further on why you think that's really sound policy?

Mr. Gary Sands: I want to reiterate, too, that the comments I am making today are based on the direct input we're getting from our various coalition members, notwithstanding what you're hearing in the media. I don't come here and stick my neck out that far. We're representing what we hear from our members, which are genuine small businesses in a variety of sectors.
The reason we favoured this from the outset, when the party that's now the government enunciated or outlined it in its election platform, is that we represent genuine small businesses and we want to see more fairness and transparency. We have advocated for that in a number of areas, and I'm not coming back to this committee in a few months to talk about credit card fees, for example, and look you in the eye and say we want more fairness and transparency and have you say, "A few months ago you said..." I struggle with that.

I am trying to reiterate that the comments I am making are based on actual feedback from genuine small business members, and the context is a continuing frustration for us, whether we're talking about the minimum wage in Ontario.... Maybe I could use that to emphasize my point. We don't want to get into a debate about the pros and cons of a 32% increase in the minimum wage in Ontario. What we always try to do is to look at the context that small business is facing right now.

We deal with a myriad of bylaws, confusing and contradictory holiday shopping, yet we have to compete with the e-commerce online, taxes—

Mr. Raj Grewal: Mr. Sands, I really appreciate it, but I only have five minutes.

Mr. Gary Sands: I'm sorry.

Mr. Raj Grewal: The question was specifically on income sprinkling and why you think that reducing the small business tax rate is more sound policy.

Mr. Gary Sands: It's that it will benefit everyone. It will be more fair. It will be more transparent, and that's the feedback we got from our members. They want fairness. They want transparency. It's exactly what you just said. Whether it is a credit card statement or the Income Tax Act, they don't want to have to hire a lawyer to understand it.

Mr. Raj Grewal: Sounds good. Thank you, Mr. Sands.

Mr. Marcoux from the CMA, thank you for your testimony. I want to know how many of your members are incorporated.

Dr. Laurent Marcoux: I told you it is 54,000.

Mr. Raj Grewal: How much is that? Is it 54%?

Dr. Laurent Marcoux: It's 66%.

Mr. Raj Grewal: Is it 66% incorporated versus salaried employees?

Dr. Laurent Marcoux: Yes.

Mr. Raj Grewal: What is the average income per corporation?

Dr. Laurent Marcoux: I will ask Mr. Feeley if he knows the average of the—

Mr. John Feeley (Vice-President, Member Relevance, Canadian Medical Association): Yes. The average, I think, would be $339,000.

Mr. Raj Grewal: It is $339,000. The average income of a small business across Canada is $73,000, and here it is at $339,000.

Mr. John Feeley: That is gross income.

Mr. Raj Grewal: Yes, the same with the $73,000.

What about employees? What is the average salary for an employed doctor?

Mr. John Feeley: The average salary for an employed doctor— I don't know.

Mr. Raj Grewal: You don't collect that data.

Mr. John Feeley: I'm sure we could find out.

Mr. Raj Grewal: Okay, it would be great if you could send that information.

I have a lot of doctor friends. I have a lot of lawyer friends, and a lot of the professionals at my age.... I practised law for a year before I was elected. They have strong feelings about these proposals because they are now getting to the point where they would benefit from them, or be taking advantage of these things. We're having a healthy debate among my own social circle on what type of country we want to live in and how important it is for a level playing field. So thank you for your testimony. We'll definitely take it into consideration to make sure there are no unintended consequences, because there is some validity to be said, especially.... Somebody gave an example of one spouse working while the other spouse attends medical school. That's an important contribution to society.

Moving on—

The Chair: We'll have to cut you off there, Mr. Grewal.

Mr. Poilievre.

Hon. Pierre Poilievre: Thank you very much.

My question is for the witnesses from Meyers Norris Penny. The government is proposing to remove the refundable dividend tax on hand that currently ensures that small businesses don't pay double taxation on their passive income. When that's removed, double taxation will be instilled in the system. What will be the highest tax rates people will pay on their passive income held within a company?

Ms. Jennifer Kim Drever: When their income is flowed out, there will be, say, a 50% immediate tax at the corporate level.

Hon. Pierre Poilievre: Yes.

Ms. Jennifer Kim Drever: When the dividends are taken out to the individual, that tax rate can be another 45% on the remaining $50. That being said, the tax rate effectively is up to 73% to 74% depending on the province.

Hon. Pierre Poilievre: Okay, and will that tax rate apply on the shareholders of publicly traded companies or just on private companies?

Ms. Jennifer Kim Drever: Absolutely not. It will not apply to public companies at all. The public company on inactive income would be paying 27% tax. A foreign-owned company would be paying 27% tax.

Hon. Pierre Poilievre: Right.
Ms. Jennifer Kim Drever: A private company is going to be 50% and a REIT is zero.

Hon. Pierre Poilievre: Right, okay. That's 50% on the private company plus the additional 45% on what's left.

Ms. Jennifer Kim Drever: Yes, so effectively, the public company ends up with a flow-through rate of just under 50%.

Hon. Pierre Poilievre: Right, and so—

The Chair: I'm not taking away from your time, Pierre, but keep in mind this is not even draft legislation and this is a proposal the consultations are on.

I don't want anybody to think that this is the law.

Mr. Poilievre.

Hon. Pierre Poilievre: But it is a very well-defined proposal as written down in the consultation document.

Will you have to advise your clients to look for other savings vehicles if this tax does go in place?

Ms. Jennifer Kim Drever: We would. We would have to look at other options for the clients if it's now cost-prohibitive to invest in their company to save for their rainy days or to help fund their economic fluctuations. We will have to look at other ways we can do that, and some of those would be, say, IPPs or RCAs or things like that, so some kinds of pensions.

Whenever we do that, though, the funds are now moved outside the company and they're not accessible to that business again to be able to survive an economic downturn.

Hon. Pierre Poilievre: The IPPs, though, which companies provide those IPPs right now as a service?

Ms. Jennifer Kim Drever: There are many companies in Canada that provide that.

Hon. Pierre Poilievre: Can you name any of the big players?

Ms. Jennifer Kim Drever: I am choosing not to.

Hon. Pierre Poilievre: I understand, but the IPP will be splittable on retirement, right? If someone has an individual pension plan, they'll be able to sprinkle their income with their spouse?

Ms. Jennifer Kim Drever: That is one of the tenets of the Canadian tax system, that income splitting is mandated. Currently, we can do income splitting with pensions. We can do income splitting with RRSPs. The only opportunity for a lot of business owners for income splitting is with multiple shareholders.

Hon. Pierre Poilievre: Finally, you represent 150,000 family businesses and your firm specializes heavily in farming. Is it true that family farmers will pay a higher rate of taxation to sell to their children under these proposals than they would to sell to an unrelated third party like, say, a multinational corporation that aggregates land?

Ms. Jennifer Kim Drever: That is absolutely correct. These rules, these new changes coming to 84.1 and 246.1, what they're effectively doing is making it so you pay double tax when you're transitioning a family business. The parent will have to pay tax first on the disposition and the kid will have to pay tax again, and not only that, the capital gain exemption is not on the table.

I also want to be clear that this is not just about corporations. Every single private business in Canada, whether it's a corporation or partnership, is going to be impacted by these rules one way or the other. There are the income splitting rules, there are the passive investment rules, and there is the inability to do a transaction with your family member. All of these put together impact every private business.

Hon. Pierre Poilievre: Mr. Wolfson, do you think the family farm is the most viable form of agricultural production?

Prof. Michael Wolfson: The short answer is I don't know.

Hon. Pierre Poilievre: You don't know. Do you think it's fair that under these proposals there would be a higher rate of taxation for a farmer to sell his or her farm to their son or daughter than to sell it to an unrelated stranger?

Prof. Michael Wolfson: As the chairman has indicated, these are proposals, and I heard a fair amount of discussion Monday of this week at the Canadian Tax Foundation conference about these proposals and my sense is it's not a foregone conclusion that what you've described is what will emerge.

A (1100)

The Chair: We will have to—

Hon. Pierre Poilievre: It is draft legislation though.

The Chair: We'll have to stop you there.

Mr. Boulerice.

[Translation]

Mr. Alexandre Boulerice: Thank you, Mr. Chair.

I would like to thank all the witnesses who are here this morning for discussing this crucial matter for many people and many businesses.

Please allow me to raise two points briefly before I get to my questions.

We've heard a lot about family farms and the challenges of intergenerational transfer. My NDP colleague Guy Caron had tabled a proposal to improve this, but it was rejected by Parliament, unfortunately. We already had this concern prior to the proposed changes that we are currently considering.

We agree with those of you who are proposing an extension of the consultation period. They began on July 18, but for many small businesses and farmers, the date was problematic. We hope to hold consultations until December 16.

As long as we're talking about tax fairness, as Mr. Roberts of the CLC said, we should discuss tax loopholes for CEOs, rules on tax evasion and international agreements we have with tax havens, who are not at all affected at this time.
Dr. Marcoux, I would just like to verify something. The doctors who are members of your association are able to buy RRSPs or put money in a tax-free savings account, right?

**Dr. Laurent Marcoux:** Absolutely, like everyone else.

**Mr. Alexandre Boulerice:** I just wanted to make sure because you said earlier that incorporation was a way for your members to save for retirement. Having said that, it isn't the only way.

**Dr. Laurent Marcoux:** It's not the only way. However, I will tell you that doctors usually enter practice around the age of 33, 35 or 36. They have a lot of student debt then, often amounting to a few hundred thousand dollars. They have to set up their practice and start a family. So they can't start thinking about investing for retirement until they are about 40 years old, when all this is reasonably accomplished.

If they invest in an RRSP, for example, at a maximum of $20,000 per year, how can they save enough capital in the next 20 years to provide them with a return and to ensure a decent retirement? They're a little stuck. They would be among the only citizens who had contributed much to society but did not have access to a suitable retirement once they reached that age. This is a problem for most of our doctors.

**Mr. Alexandre Boulerice:** Do you find it normal that the tax system is being used to provide doctors with the opportunity to incorporate in order to compensate for the fact that the provinces don't have the resources they would like to give your members a salary increase?

**Dr. Laurent Marcoux:** It's a legitimate question, but I can't provide an answer on the consequences of a federation made up of different levels of government. I will refrain from answering that question.

**Mr. Alexandre Boulerice:** Thank you, Dr. Marcoux.

Mr. Burello, thank you for your very enthusiastic presentation. I have two questions for you.

First, people like Mr. Wolfson or Mr. Roberts told us that most of the repercussions of the government's proposals that we are looking at right now are going to affect only a small portion of small businesses or family farms in Canada because most of them did not have the income to make it very advantageous for them. Your association, as well as others, has the view that there would be a very broad impact on all of the people you represent. These are two incompatible visions.

What are your thoughts on that?

*English*

**Mr. Eddy Burello:** First of all, as I said, for all private corporations, their owners, death and taxes are inevitable.

**Mr. Alexandre Boulerice:** When?

**Mr. Eddy Burello:** Right now. I haven't figured out a solution to avoid that.

Right now what I do know is that when owners of private corporations pass away, the rules under sections 84.1 and 246.1 are adversely affecting them because they'll pay double the tax. Our system today allows for the elimination of one tax, which is rightfully so. Private owners of private companies should only be expected to pay one. That affects all private companies. There's not a subset; all of them are impacted by that rule.

I'm not so sure about the statistics; I'm not a statistician. I would tell you that all of our 150,000 private company family businesses are going to be impacted by this rule.

**The Chair:** Thank you, all.

I'll turn to Ms. O'Connell.

**Ms. Jennifer O'Connell:** Thank you, Mr. Chair.

Mr. Marcoux, I'm really interested in your testimony in particular, because you talked about the health of the economy. Yesterday we heard testimony that mental health issues, for example, cost our economy $51 billion, and the ask was relatively small in comparison to that.

It has been stated over and over again that, if the money in these corporations is actually used for the business, nothing changes with these proposals. Yet you said this is going to stifle growth and services. The changes to these policies apply only to situations where money is removed for personal income tax reasons. I'm very curious to know how you think this is going to stifle growth and services, when the only change and the only impact is on personal income taxes. If the money is actually used and invested in the business, then there is no actual change.

My real question to you is this. We've been hearing more and more from doctors who disagree with the CMA's position. I'm wondering if you might be out of touch with your members. Do you actually think your members like the idea that tax policy—this is similar to Mr. Boulerice's question—should replace fair compensation, and are you actually now advocating for greater inequality among your membership? If you look at the chart that Mr. Wolfson provided, you see that in Ontario doctors are provided a greater benefit than maybe in other provinces. We've seen certain doctors who are on hospital lists that have no risk for collection, they don't employ anyone, but if they're a private corporation they can divert and pay less income tax. Even general practitioners don't have that same option because they would have to pay out in different ways.

Are you worried that you might be contributing to greater inequalities among medical professionals? You're advocating for a system that, even amongst your own members, even among doctors, doesn't have the same access for all to this type of diversion of taxes.

**The Chair:** I think the analyst gave Mr. Feeley the chart there, because I don't think he had a copy of it.

**Ms. Jennifer O'Connell:** Thank you.

**The Chair:** Go ahead, Mr. Marcoux.

**Dr. Laurent Marcoux:** I would just answer that we have a great variety of practices in our profession. There are doctors in research, doctors providing service, and that's why not all doctors are incorporated. About 66% of doctors are incorporated, and that supports their practices. That we know. Incorporation supports their practices.
What we also know is that there are unintended consequences. We have some examples from the past. In 1992 when we lowered the enrolment of students at university by 10%, it had a big consequence for the future. We lost so many doctors, four graduations each year, for many years. It took a long time. When we make changes in taxation—we are talking about tax changes here—we don't know the consequences. Doctors are coming from outside Canada, very expert doctors. We need them here. What will happen with our very expert doctors here? Will they leave?

They are in demand everywhere in the world. They stay here because this is their country and their patients are here, but sometimes there's a lack of trust and they could leave. The consequences are not to be neglected.

Ms. Jennifer O'Connell: Right, but in fairness, sorry, my question was about the inequality among... If you want to have the debate about leaving, I have some experience and I understand. To go to the U.S.... For example, doctors have liability insurance covered here. They have billing collected. They don't have some of these things elsewhere, so if you want to talk about those business cases, we can, but I'm talking about the inequalities.

Can you at least acknowledge that, among your membership, the highest income-earners certainly will benefit from these tax changes where others within your membership don't, and would it not be better to use this type of money that costs the federal government for investments in health care, and—to Mr. Boulcerie's point—look at the structural issues of not using tax policy to determine fair compensation?

Dr. Laurent Marcoux: I wasn't on the first line for all the reasoning and the arguments that our member had. I have a feeling he may be more aware of what the answer was from our members when we did our survey on this.

The Chair: Thank you.

Mr. Feeley:...quickly.

Mr. John Feeley: There was lots of diversity of opinion within the membership. We welcomed it and we're hearing it today. I think it results in a better policy decision and outcome.

Keep in mind that incorporation doesn't work for all physicians, necessarily. Also, it's important to note that the primary care medical infrastructure in Canada is owned and operated by physicians. They're investing in those practices every day, and it's hard to retain earnings to invest in their businesses. They do so, but the proposals could create a lot of uncertainty about what the outcome would be, because you can only take things out for retirement at the end of your career. You have to make investment decisions throughout that period.

The Chair: Thank you. We're slightly over.

I would remind members that Mr. Lammam from the Fraser Institute is still there, I gather.

Are you there, Mr. Lammam?

Mr. Charles Lammam: I am.

The Chair: We can't see you, but I remind members that you are available to answer any questions that people have.

We'll turn to Mr. Kmiec.

Mr. Tom Kmiec: Maybe I'll start with Mr. Wolfson.

I have a quotation from you from an interview you did while in Alberta that there are more effective ways to organize Canadian farms away from the family farm. Can you comment and expand on that?

Prof. Michael Wolfson: As I said in response to Mr. Poilievre's question, I don't know what the pros and cons are.

The situation whereby one can have more than one million-dollar capital gains rollover—three, four, five of them—is one concern the finance proposals are addressing. If one had only one million-dollar rollover, that would have an effect, presumably, on heritability without more tax liability for a family farm.

As to your question, 90%—I was surprised when I looked at the numbers this past weekend—of farm businesses are incorporated. There are, then, already corporations. The legal structures involved in farms are very complex. There may be one company that owns the machinery, another company or organization that deals with leased land. Unfortunately, we don't have the data to understand that. Whether one legal structure or another or a mix of legal structures is the most efficient way to organize this or that kind of farm, I simply don't know. I think it's an open question, one that merits some careful analysis.

Mr. Tom Kmiec: You did an interview on September 7, 2017, on CBC's Alberta@Noon show and spent the whole show talking partially about the family farm, because you're credited with a lot of inspiration for the rules that will affect the family farm. Your work is being credited publicly by the minister and others as being the inspiration for it.

I agree with you that the tax law in this is complex. That's why there's MNP trying to interpret it on behalf of farmers. While they're busy working on their family farm, MNP is giving them advice on how they should structure their business in order to avoid unnecessary taxation and also be able to pass it down to the next generation.

You had a farmer phone in who said that farmers work their whole life to pass down their land. The kids work on the farm for little wages, knowing they will receive that land eventually, and these changes will potentially increase tax on a disposition of land to children. He said the family farm will be destroyed. He's talking about these proposals. He says this will result in more large-scale agri-farming—"Big Ag", as he calls it—at the cost of the family farm.

Do you think he's correct?

Prof. Michael Wolfson: It's important to look at the whole transcript. It was a half hour that I was on. First, the entire show was not on family farms. That was maybe five or seven minutes of it. I think that same caller said, “By the way, my kids aren't working on the farm anyway.” He wasn't going to pass it on to his kids, you'll see, if you keep reading through the transcript.
Mr. Tom Kmiec: He's just one example. One consideration for many kids is the tax efficiency of it and whether they want to continue to be in the business, because there are many disincentives to continuing. Being a farmer makes for a hard-working life, for one thing, and then on top of it you pay huge amounts of tax.

In the proposal the government has before us—the one we're studying, the one we're here for—it's double taxation. Repeated witnesses have said that you'll be taxed on the estate side, you'll be taxed on one end, and taxed again on the other end. It's another disincentive to continue multi-generational farming, multi-generational ranching.

Ranching is big business. It's also a family business in Alberta. Entire regions of Alberta are named after the original family farms and original ranchers who were there. Do you think the family farm is obsolete?

Prof. Michael Wolfson: I don't know that the family farm still exists in most cases. You may fly over a parcel of land that looks like one farm, but it's really a variety of legal structures and parcels spread all over. I also heard a senior Finance official, on Monday during the discussion of this thing, raise questions about the interpretation. I'm not a technical tax expert. It's been a long time since I was involved, but they were saying that this interpretation is not necessarily correct.

Mr. Tom Kmiec: Madam Drever, I saw you shaking your head at that statement. You are the tax expert. You deal with this. You administrate these taxes. Can I get your opinion on this?

Ms. Jennifer Kim Drever: I am from the Peace region of Alberta. Just for the record, I believe there the stat is that there are more arable acres in that region of Alberta than there are in the entire province of Manitoba. We have a lot of farm clients in that area, and there are corporations of farmers. The reason for that is that the land and machinery costs are so capital-intensive that it is impossible to repay the debt on that land using personal tax dollars. We have to incorporate those farms to pay back capital at corporate tax levels instead of personal tax levels.

The other reason is that there is so much fluctuation in a family farm. They say you have one good year and one disaster every five years. In that good year, you have to be able to save some of your money to fund the disaster, because it is coming.

The Vice-Chair (Hon. Pierre Poilievre): That concludes the questioning.

Mr. McLeod.

Mr. Michael McLeod (Northwest Territories, Lib.): Thank you, Mr. Chair, and thank you all for the presentations. It's a very interesting discussion today.

The Income Tax Act for sure is very complicated and complex. I'm not a tax expert, and God help you if I try to advise you on how to save money, because I'm not good at that either.

I want to point out, however, that the consultation process is on now, and we want to hear what the public and the experts have to say. We have no legislation on the table yet, but that gives more opportunity for input.

As I'm listening, I'm wondering, because the corporations have to incorporate that set-up and there are a lot of rules around the tax system. I want to ask if someone could tell me what it takes for these corporations to do their taxes at the end of the year. If the system is so complicated, as many have indicated, that you need lawyers, accountants probably. Could somebody tell me what an average corporation pays for an accountant to do taxes?

Ms. Jennifer Kim Drever: That's actually a very complex question. It depends on the complexity and what is going on in that company. It also depends on what level of financial statements the bank would require.

Mr. Michael McLeod: What's the average?

Ms. Jennifer Kim Drever: For a small business that has “notice to reader” financial statements, I would expect the average to be somewhere between $1,500 to $2,500.

Mr. Michael McLeod: How many clients would an accounting firm deal with?

Ms. Jennifer Kim Drever: It depends on the size of the accounting firm.

Mr. Michael McLeod: I'm assuming every corporation has a firm doing its taxes.

Ms. Jennifer Kim Drever: Every corporation has to file a tax return. That doesn't necessarily mean they have an accountant who does it for them.

Mr. Michael McLeod: I think maybe the language is a little too broad in the Income Tax Act, too complicated, and maybe it should be tightened up so it's clearer.

I'm also wondering if all professional corporations are permitted to engage in what is called “income sprinkling”. Is everybody able to do that?

The Chair: Who wants to take that on?

Mr. Burello.

Mr. Eddy Burello: The answer is no, and there are many reasons for it. Some people don't have multiple family members to sprinkle with, so not all professional corporations can do it. There are definitely restrictions in certain circumstances. There are also provincial rules. Some provincial rules prohibit family members from being part of professional corporations, so there's a regulatory issue in such circumstances that prohibits the sprinkling of income.

Mr. Michael McLeod: Thank you for that. That was puzzling me.

The other thing that is difficult for me to understand is that the passive investment income is intended to help the company, the business, grow, to invest, but now we're seeing it change, and there's an ability to use it as a personal savings account for your retirement savings.

Is that what the initial intention of this legislation was? Is there a comment from anybody around the table?

Mr. Eddy Burello: I'll jump in on that one. I'm not sure what the intention of the original legislation was.
I would say if there's a concern, as the name implies “passive”, I would tell you that most Canadians don't have passive capital. All capital has been deployed in some fashion one way or another. Some capital is reserved to be put back into their businesses. Other capital is reserved to be put back into the economy in some form of investment.

There is really no such thing as passive investments. I'm not exactly sure what the intent was. That passive investment is currently taxed. It's not like there's no taxation on that investment. I'm not exactly sure how to answer your question, but I would tell you all capital is deployed.

The Chair: And we are going to have to—

Mr. Charles Lammam: I would like to comment if I can.

The Chair: Okay, Mr. Lammam, if you could fairly quickly.

Mr. Charles Lammam: There's a broader point that I think is absent from this debate about how the tax changes will affect behaviour, and it's completely missing from the working paper provided by the Department of Finance.

Basically it assumes there will be no behavioural response from any of the proposed tax changes, which is really contradicted by the evidence. Whether we're talking about increasing tax rates on passive investment income, or whether we're talking about increasing tax rates on professionals who are now using strategies to lower their tax burden, the paper doesn't acknowledge that there will be a response. The response can take the form of people working less as a result of the higher taxes that they will pay. It can mean professionals passing on the extra costs in the form of fees to the extent that they can to their consumers, or that there will be less investment taking place, and frankly there will be new and different forms of tax planning in response that work around the rules. We've already heard about that in this discussion.

All of those types of activities are not going to help improve Canada's economy. I think it's a key aspect of this proposed legislation that is completely missing from the debate. We need to understand that these changes will have economic consequences, and it's not in line exactly with what this government wants to do, which is grow the economy.

The Chair: Thank you very much. I expect you will make that comment next week as well on the pre-budget.

Mr. Albas.

Mr. Dan Albas: Thank you, Mr. Chair.

Thank you to all our witnesses.

I'd like to go first to MNP. Thank you for being here today.

This is a direct quote from a prominent member of the Liberal Party of Canada: "Speaking of tax changes, I want to be clear: people who make $50,000 a year should not pay higher taxes than people who make $250,000 a year.”

First of all, from your opinion, under our current system as it stands without any of these changes in place, is that a possibility?

Ms. Jennifer Kim Drever: Absolutely not. A corporation earning $250,000 is going to be paying at least a small business deduction rate at the corporate level—at least. Somewhere along the line either Eddy and I are really bad at our jobs and we haven't figured out how to make that math happen yet, or it's not possible.

Mr. Dan Albas: Okay. Another prominent person within the Liberal Party has said in an op-ed that these changes would not affect people under $150,000, so for passive income investment to provide an advantage over and above what's available to every Canadian through RRSPs and TFSAs, a business owner would need to earn more than $150,000. Is that correct?

Ms. Jennifer Kim Drever: That isn't actually correct because many businesses that are under $150,000 still compensate their shareholders via dividends versus a salary, and they do that for many reasons. One is cash flow.

One of the things for a lot of these small business—because they may be start-ups or because of different things—is that they don't necessarily want to compensate themselves via a salary. The reason for that is, if you were to take a salary, you could be creating losses in that company that are not good for anything. It also makes the balance sheet look bad, and it makes the income statement look bad for the lenders. A lot of these business owners wouldn't take a salary, so they don't create the RRSP room to start with.

In my experience, I have yet to see a start-up business or a small business making a level of income taking salaries to their shareholders.

Mr. Dan Albas: That's a very good point, because oftentimes, for an RRSP to be an effective strategy, you have to start very early and be consistent with it.

Ms. Jennifer Kim Drever: You do, and you have to be taking out a significant amount of salary every single year in order to create the earned-income room for the RRSP.

Mr. Dan Albas: Again, as we know, many small businesses are not successful for whatever reason. It is quite a risk.

The current proposal around passive investments obviously does not apply to public companies. I believe you said that earlier.

If someone is looking to do a tech start-up, for example, that is very risky because who knows how the marketplace will play out? With start-ups, especially in Canada, families are the first line of investment because banks will not lend a lot of money on an untested concept. Are we creating a different playing field for a start-up company to be able to gather investment to start up first as a public company?
Ms. Jennifer Kim Drever: We absolutely are. There are so many parts of these new rules that impact those start-ups. If we were to start with say, two brothers both under the age of 25 starting up a business together, they are going to be impacted by those tax on split income rules. It's not just about the spouses and the kids. Any related person who owns shares in that company, yourself included, could be impacted by that. Firstly, they could be taking out, say $30,000 a year in dividends, and they are paying the maximum tax rate on that. They are paying 45% on that in Ontario.

The Chair: Thank you. We'll have to cut it there.

We have time for one single question from Mr. Fergus, and then we'll have to adjourn.

Mr. Greg Fergus: Thank you all for coming today.

Mr. Wolfson, I am just following up on Ms. Drever and this whole discussion regarding retirement. I noticed in your comments that you didn't talk about the purpose of using these retained earnings, using a CCPC for retirement. I wonder if you have some thoughts on that. Is there good rationale for it?

Prof. Michael Wolfson: I do have some thoughts. For the members' benefit, I spent 1983 on the research staff of the special Parliamentary committee on pension reform, and that was the committee, among other things, that recommended comprehensive limits for tax assistance for retirement savings.

It was flowing from that, I think, that the Department of Finance increased the RRSP limits to what you see now to bring them in line with the limits on defined benefit pension plans in order to equalize the access to tax assistance for the self-employed or people who didn't have a workplace pension plan.

In one of our discussions, one of the members of that committee said that a fair maximum for tax assistance is about the income of a high school principal. In fact, the access to tax-assisted retirement saving is somewhat higher than that, but in the ball park.

I was really surprised by a witness before the break who said they needed to be able to retain earnings in their private company, not only to capitalize the company but for retirement savings and to pay for their children's education. There are other ways to pay for children's education.

I get love letters because of some of the articles I publish. One person emailed me and said, after a bit of discussion, that he had graduated with $150,000 of student debt. He was a doctor, and he was able to pay it off. It took him three years to pay it off. My God, as I say, this is a real world example.

Back to the retirement savings, I don't know the details. I was just looking at section 8515 the other day for these individual pension plans. We used to have an issue many years ago when I worked in finance about what we called “top hat” plans, and it seems to have been tightened up considerably, but I assume it's still the case that you can buy retroactive plan enrichments. If you pay yourself a $20,000-a-year salary, which is relatively minimal, in order to set the foundation, and then you come along toward the end of your career and start paying yourself $100,000 or $200,000 a year for the last five years in a final average plan, you could buy back past service based on the multi-$100,000 salary. I think there are things that one might want to look at.

The Chair: We are going to have to cut you off there, Mr. Wolfson.

On behalf of the committee, I want to thank all the witnesses. We've covered a lot of ground in this panel and the previous one this morning. On behalf of the committee, I appreciate your taking the time to come forward with your points of view and your answers in this fairly active discussion on tax planning. Thank you.

With that, we will suspend for a couple of minutes until the minister arrives.

The meeting is suspended.

Prof. Michael Wolfson: I do have some thoughts. For the members' benefit, I spent 1983 on the research staff of the special Parliamentary committee on pension reform, and that was the committee, among other things, that recommended comprehensive limits for tax assistance for retirement savings.

It was flowing from that, I think, that the Department of Finance increased the RRSP limits to what you see now to bring them in line with the limits on defined benefit pension plans in order to equalize the access to tax assistance for the self-employed or people who didn't have a workplace pension plan.

In one of our discussions, one of the members of that committee said that a fair maximum for tax assistance is about the income of a high school principal. In fact, the access to tax-assisted retirement saving is somewhat higher than that, but in the ball park.

I was really surprised by a witness before the break who said they needed to be able to retain earnings in their private company, not only to capitalize the company but for retirement savings and to pay for their children's education. There are other ways to pay for children's education.

I get love letters because of some of the articles I publish. One person emailed me and said, after a bit of discussion, that he had graduated with $150,000 of student debt. He was a doctor, and he was able to pay it off. It took him three years to pay it off. My God, as I say, this is a real world example.

Back to the retirement savings, I don't know the details. I was just looking at section 8515 the other day for these individual pension plans. We used to have an issue many years ago when I worked in finance about what we called “top hat” plans, and it seems to have been tightened up considerably, but I assume it's still the case that you can buy retroactive plan enrichments. If you pay yourself a $20,000-a-year salary, which is relatively minimal, in order to set the foundation, and then you come along toward the end of your career and start paying yourself $100,000 or $200,000 a year for the last five years in a final average plan, you could buy back past service based on the multi-$100,000 salary. I think there are things that one might want to look at.

The Chair: We are going to have to cut you off there, Mr. Wolfson.

On behalf of the committee, I want to thank all the witnesses. We've covered a lot of ground in this panel and the previous one this morning. On behalf of the committee, I appreciate your taking the time to come forward with your points of view and your answers in this fairly active discussion on tax planning. Thank you.

With that, we will suspend for a couple of minutes until the minister arrives.

The meeting is suspended.

Prof. Michael Wolfson: I do have some thoughts. For the members' benefit, I spent 1983 on the research staff of the special Parliamentary committee on pension reform, and that was the committee, among other things, that recommended comprehensive limits for tax assistance for retirement savings.

It was flowing from that, I think, that the Department of Finance increased the RRSP limits to what you see now to bring them in line with the limits on defined benefit pension plans in order to equalize the access to tax assistance for the self-employed or people who didn't have a workplace pension plan.

In one of our discussions, one of the members of that committee said that a fair maximum for tax assistance is about the income of a high school principal. In fact, the access to tax-assisted retirement saving is somewhat higher than that, but in the ball park.

I was really surprised by a witness before the break who said they needed to be able to retain earnings in their private company, not only to capitalize the company but for retirement savings and to pay for their children's education. There are other ways to pay for children's education.

I get love letters because of some of the articles I publish. One person emailed me and said, after a bit of discussion, that he had graduated with $150,000 of student debt. He was a doctor, and he was able to pay it off. It took him three years to pay it off. My God, as I say, this is a real world example.

Back to the retirement savings, I don't know the details. I was just looking at section 8515 the other day for these individual pension plans. We used to have an issue many years ago when I worked in finance about what we called “top hat” plans, and it seems to have been tightened up considerably, but I assume it's still the case that you can buy retroactive plan enrichments. If you pay yourself a $20,000-a-year salary, which is relatively minimal, in order to set the foundation, and then you come along toward the end of your career and start paying yourself $100,000 or $200,000 a year for the last five years in a final average plan, you could buy back past service based on the multi-$100,000 salary. I think there are things that one might want to look at.

The Chair: We are going to have to cut you off there, Mr. Wolfson.

On behalf of the committee, I want to thank all the witnesses. We've covered a lot of ground in this panel and the previous one this morning. On behalf of the committee, I appreciate your taking the time to come forward with your points of view and your answers in this fairly active discussion on tax planning. Thank you.

With that, we will suspend for a couple of minutes until the minister arrives.

The meeting is suspended.
The fact is that when you talk to people across the country, there is a lot of anxiety that the next generation—your kids or your grandkids—may just not be as well off as the generation of today. That's what motivates me, and that's what motivates our government. We want to make sure we create the conditions for all Canadians to succeed in what we know is a changing economy. To get there, I am committed to ensuring a healthy, thriving business environment and to protecting Canadian businesses' ability to invest, to grow, and to create jobs.

I think it's worth starting by taking a look at where we are right now. When we came into office a couple of years ago, we made a commitment to invest in Canada's middle class. We lowered taxes on middle-class Canadians and increased child benefits for those most in need. We invested for the long term in our infrastructure, because we saw this as critically important to the future of our country and to the future of our economy.

Right now we're the fastest-growing country in the G7 countries, and by a wide margin. Our economy over the last quarter grew at an impressively strong 4.5%, faster than it's grown since the beginning of 2006. In the two years since we've come to office, 400,000 new jobs have been created. Thanks in part to strong economic growth and the smart investments we've made in Canadians and for Canadians, we find ourselves with a fiscal position that's much stronger than we anticipated even only as recently as March. For the fiscal year that ended March 31, our budget deficit is $11.6 billion less than what we had projected only a relatively short while ago in budget 2016.

That's all good news, but we need to face facts. Growing the economy is not good enough. We have to work to make sure that the fruits of that economic growth go to all Canadians.

[Translation]

We need an economy where all Canadians, and not just a very small group of the wealthiest, should benefit from the advantages and opportunities that go along with this economic success.

[English]

There's still work to do to ensure fairness for middle-class Canadians. That's what we're talking about when we talk about our tax system—ensuring that everyone benefits from our economic growth, not just the wealthy few. From the very beginning, we said that we want an economy that benefits the middle class and all those people who are working hard to improve their situations. At the heart of that goal is a very simple premise: every Canadian needs to pay his or her fair share of taxes. That's why one of my very first acts as finance minister was to raise taxes on the top 1% so that we could cut them for nine million Canadians across our country.

One of my principal responsibilities as Minister of Finance is to ensure that our tax system is fair, efficient, and supports growth, and that it is also equitable and treats all Canadians fairly. I want you to know that I take these objectives very seriously. In each of our first two budgets, we put tax fairness front and centre, backed by significant new investments in our economy. We increased resources for the Canada Revenue Agency to improve the enforcement of tax laws that are already in place. We also continue to participate in efforts with our global partners to combat international tax evasion and avoidance.

But we're not done yet.

Honourable members, setting up a private corporation offers hard-working, middle-class business owners the ability to sell shares, raise capital, and limit liability. It gives them access to the lowest small business tax rate in G7 countries, but we know that, for the wealthy, incorporation offers something different. In some cases, it offers something quite different. What that means is that a high-income, incorporated professional can be taxed at a lower rate—for example, in the case of a doctor taxed at a lower rate than a salaried nurse practitioner working in the same office.

As the economy grows, Canadians need and deserve to know that their tax system is fair. Right now, we're just pointing out that it's not. These are big changes, and we know we need to get them right. We know we need your help and your feedback on what we're trying to achieve. That's why Minister Bardish Chagger, my new parliamentary secretary Joël Lightbound, and I are visiting small business owners, professionals, farmers, and fishers across the country and listening to ideas and answering questions.

Yesterday I spoke with Canadians across our country during a Facebook Live event and with a teleconference town hall. Tomorrow, I will be meeting with what I expect will be hundreds more in Oakville. We know it's important that we listen to people's concerns and that we listen to their ideas. It's also important for us to clearly state that hard-working Canadians, hard-working small business owners, and middle-class Canadians are clearly not the focus of our proposals.

To hard-working family farmers, we want you to know that we support you.

We know, for example, that 80% of the passive income in this country is earned by 2% of the CCPCs that are out there. The measures we're proposing will only affect a very small number of private proportions and a very, very small number of Canadians. Small businesses will continue to benefit from the lowest small business tax rate among G7 countries. The changes to the tax system being proposed will not impair a business's ability to invest, to compete, or to grow. The proposed approaches in addressing passive investment income are not about money that's being invested in a business. They're about money that's being taken out of the business, ensuring it's being taxed fairly, ensuring that the small business tax rate and the corporate tax rate actually help to support economic growth and do what we want them to do, which is to create jobs for Canadians across the country.

We're always open to better ways to fix the problems that we've identified in our consultations. But I want to be clear. We're going to fix them, because our government was elected to help to grow the middle class.
Mr. Chair, I would be pleased to take questions from the honourable members.

The Chair: Thank you very much, Mr. Minister.

I believe we have a hard stop at 12:30, so that means we can get about eight people in at five minutes each, starting with Mr. Sorbara.

Mr. Francesco Sorbara: Thank you, Mr. Chair.

Welcome, Minister.

Tax fairness is something very important for all Canadians. They want to know that they have confidence in our tax system, in terms of delivering services to citizens from coast to coast to coast. Just as important, we want to ensure that we have a strong social fabric and a strong economy. We need those through a tax system that incentivizes the right things to do and doesn't incentivize folks to do things that they really shouldn't and that the tax system is not there to do.

What I would like to know, as someone with a finance background, is that the tax fairness can be put to use and can be used as a mechanism for growing the economy and increasing investment in Canada.

Hon. Bill Morneau: Maybe I can just start by saying thank you, because I know that you've heard from many of your constituents, many people, whether they're professionals or small business owners in your riding, and you've come to me with the comments and come to me with the ideas that people are bringing forward. It's really only with this that we can get these proposals right. That is in fact what we're trying to do.

I will say that we have really important objectives in dealing with a tax system that's created, over the last half a generation, an increasing ability for people to use tax planning so that they get themselves into a lower tax rate than other Canadians. Going along with that, as people do that tax planning, more money doesn't go into the active business but instead is invested in passive investments that are essentially intended to stay there for the long term and not actually advance the business, that's money that doesn't go into our economy.

We decided, as a country—and I think that decision was a good one, and it was by successive governments—to have low corporate tax rates that encourage investment, and low small-business tax rates that encourage people to start and grow a small business. But when those encouragements leave money not actually doing what we hoped it would do, growing the business, we are not doing what we hoped. We are trying to encourage people to invest in their active business with a low tax rate, and at the same time make sure that they reinvest in that business by creating the incentive for them to do so, and if not, for them to take the money out of the business, as they will, for the management of their family affairs.

We think that these incentives will help to create a tax system that's fairer and also improve our economic activity.

Mr. Francesco Sorbara: Thank you, Minister, for that answer.

In the last decade or so, business investment levels in Canada have not been where they should be. There is a lot of capital sitting in passive investments that could be put to use, creating jobs in Canada. We are doing well. We have an unemployment rate of 6.2%, a participation rate that's ticked up, 400,000 new jobs created, and we have a very sound financial footing with our triple-A rating. It seems to me that there is a lot of capital out there that could be incentivized to be put back into the economy, which may not be being utilized at this moment in time, and I would love to hear your thoughts on that aspect.

Hon. Bill Morneau: We couldn't agree more. Keeping the tax rate low for small businesses we think is critically important. We think it does encourage people to make investments in their business, but, as I mentioned, if those encouragements don't land the business making investments in their active business, then it's not having the desired impact.

You point out the amount of investment that we have in this country. We have significantly lower investment than in a like situation in the United States, about a 30% lower investment with about 25% less productivity in our businesses. We do need to realize that it's important to get people to invest in businesses. That's what will create jobs. That's what will allow the middle class to thrive in our country. Starting with a fair tax system gives the next generation of people the incentive to actually make those kinds of investments in businesses for the long term. We know that a fair tax system, and one that encourages investment, can go side by side and make a real difference for Canadians.

Mr. Francesco Sorbara: Thank you, Minister.

The Chair: Thank you both.

Mr. Poilievre, you have five minutes.

Hon. Pierre Poilievre: Thank you, Minister.

When small businesses set aside money within their company in anticipation of their need for sick leave, for a rainy day, or for retirement, they already pay a tax rate of between 50% and 55% on the resulting passive income. You've said that's not enough. You want to raise the rate by taxing that money a second time when the owner takes the money out. In fact, the rate they pay is the same as shareholders ultimately pay in a larger public company that trades on the stock market. You say this is about fairness, that everyone should be treated equally. Fairness is a relative term. By comparison, what rate of taxation did you pay when you sold your $30 million of shares in Morneau Shepell?

The Chair: I really don't think that relates to this discussion, but you're welcome to answer it, Minister.

Hon. Bill Morneau: I'm happy to talk about why we think the system needs to be rethought for some of these advantages.

What we have right now is a system where if a business is encouraged to be started, because we have a low tax rate, then those business owners or those professionals can go into that situation and make some investments in that business. If they make profits in that business, they have the advantage of a very low tax rate, and that's encouraging them, we hope, to invest in that business to allow it to continue to grow.

What's very clear in our proposals is—
Hon. Pierre Poilievre: Mr. Chair, the question relates to the comparison of tax rates between those paid by a small business that invests income, invests funds, to prepare for sick leave, retirement, or a rainy day, and the tax that is paid by wealthy executives of companies that trade on Bay Street. I can depersonalize it and ask it in general.

The Chair: Then that question is fine.

Hon. Pierre Poilievre: Let me just ask then—

The Chair: Let's not personalize this discussion.

Hon. Pierre Poilievre: Let me just ask about any retiring executive who draws passive income out of a publicly traded company. The total maximum tax rate that person would pay is around 55%. You propose double taxation on small private businesses that leads to rates much higher than that.

Why is it that you believe companies that trade on Bay Street should pay a significantly lower tax rate on their passive income than the ma-and-pa corner stores have to pay on theirs?

The Chair: Mr. Minister, you have equal time.

Hon. Bill Morneau: As I said, I'd like to answer this question and perhaps help to illuminate a misunderstanding from the honourable member.

What we have here is a situation where we propose that the small business tax rate be continued and that people investing in small business continue to be able to take that money that they earn in their business and invest it in their active business. We also propose that they decide to leave that money in the business to make active investments in the future, that this is something that should be encouraged—

Hon. Pierre Poilievre: The question was about passive income, Mr. Chair. The member is going back to his PMO talking points—

The Chair: Mr. Poilievre—

Hon. Pierre Poilievre: Let him answer the question that was asked.

The Chair: The minister has the opportunity for equal time to answer and I'm going to give him that.

Mr. Minister.

Hon. Bill Morneau: When those monies are invested back in the active business, then that will continue to be a significant advantage. That money left passively in the business is intended to be there in order to create the opportunity for future investments. If it's taken out, however, of course, it pays a tax rate which is a similar net tax rate to what someone might take when they have a dividend or salary from any other company.

What we're saying is that we want to make sure that we don't create an incentive for people to have an investment account inside their company that creates an advantage from those returns on those investments. The continuing small business tax rate on the profits inside the business—

Hon. Pierre Poilievre: Mr. Chair, he has had the same amount of time that I had.

The Chair: No, he hasn't.

Hon. Bill Morneau: We see this as something that's going to take away an advantage for wealthy business owners that grows as that business gets bigger, but one that really will not impact the business that invests actively in their business, the business that takes money out of their business, or the business that is not able to take a huge advantage from significant investment returns on a retirement account inside their company.

The Chair: I'll have to cut you off there, Mr. Minister.

You have two more rounds coming on your side, Pierre.

Mr. Boulerice.

[Translation]

Mr. Alexandre Boulerice: Thank you, Mr. Chair.

Mr. Minister, thank you very much for being with us today.

Obviously, as progressives, the New Democrats welcome any initiative that enhances fairness in the tax system. Some of the directions proposed in the documents presented move in that direction, and we recognize that, although we have some concerns about the impact this may have, particularly on farmers and some small businesses.

However, we believe the issue of fairness should be directed primarily at the wealthiest people, not those who have a family farm or a small convenience store around the corner. That's why we consider these consultations to be partial, incomplete. We have already asked that the whole tax system be assessed, including tax evasion, use of tax havens and certain loopholes.

In that regard, during the last election campaign, your party promised to “undertake a wide-ranging review of the over $100 billion in increasingly complex tax expenditures that now exist”. However, the proposed consultation today totally ignores the tax loophole for CEO stock options, which are often set up on Bay Street. But, collectively, it costs us $750 million a year. You made that promise, but you aren't following through. You have excluded it from the current consultations.

Why wouldn't we study this tax loophole, which is really very costly for us?

Hon. Bill Morneau: Thank you very much for your question.

It is very important for us to consider how to have a fairer tax system. It's a very important goal.

As you said, our primary objective was to test the feasibility of that, which is very important.

More than two years ago, we explained that it was important to consider private companies because they offer the opportunity for the richest people to use tax planning that allows them to pay less tax.

Having considered this for one year, with the assistance of an expert panel, we concluded that it was very important to include these measures in our consultation paper. That is our goal right now. We want to find a way to improve our tax system in the most important areas that provide benefits to the richest.
It is important to listen to the comments, which is what I am doing. It is very clear that there are ideas to ensure that farmers and small- and medium-sized enterprises understand that our goal is not to try to change their situation, but to allow them to have a better situation in the future.

Mr. Alexandre Boulerice: I have another question, Mr. Minister. I'll come back to my image, which many have shared; I have the impression that you are a funny fisherman who keeps the small fish and throws the big ones back in the lake.

As for the use of tax evasion and tax havens, your party voted in favour of the NDP motion to address tax avoidance issues in tax havens, which Statistics Canada states costs us about $8 billion a year in taxes and in unpaid taxes in Canada, which is considerable.

However, we don't understand why you signed a new agreement, for example, with the Cook Islands, which have a 0% corporate tax rate. So things are moving in the same direction as in previous years.

A lot of people are telling us that a change could simply be made to subsection 95(1) of the Income Tax Act and section 5907 of the Income Tax Regulations to ensure that income that returns to Canada following a deposit or transfer to a tax haven can be taxed and to collectively return money to pay for our social programs or infrastructure, among other things.

Why are you refusing to go in that direction?

Hon. Bill Morneau: Thank you for your question.

We are maintaining an approach that considers the most important things, and this is very important.

Mr. Alexandre Boulerice: It would be very important.

Hon. Bill Morneau: That's why we decided to allocate $1 billion more to the Canada Revenue Agency to root out tax evasion. This is very important and is under way.

That's why we've signed an agreement with our international partners to find a way to consider the erosion of the tax base and the transfer of profits, in other words, how companies can find a place where tax rates are lower, at a level that is not appropriate for companies. It is important.

That's why we have an agreement with our international partners on the common reporting standard. That way, we can consult accounts around the world to see how we can ensure that people pay their fair share.

So we're doing several things at once. It's very important to find the most important things, which is exactly what we're doing. The current measures are the most important, making it possible to see how the wealthiest manage their affairs in order to pay tax at a lower level than the rest of the country's citizens. We will continue along this path. We'll listen to the observations to ensure that we are taking the right approach.

It's very important.

[English]

The Chair: Minister, we'll have to go to the next question.

Ms. O'Connell.

Ms. Jennifer O'Connell: Thank you, Mr. Chair.

Minister, we've heard some interesting testimony on the tax proposals. I want to point out that the Canadian Centre for Policy Alternatives presented and also provided a paper. I am going to quickly read a point from it, “Nearly all of the families who benefit most from income sprinkling are headed by male income earners, which undercuts claims that the current loophole is positive for gender equality, and almost half of all benefits flow to the richest 5% of families”.

We also heard testimony this morning that I found very interesting. It was somewhat of a different take on gender inequality. This might not be verbatim, but one of the things said was that women were used to keeping a low-tax lifestyle, and that continuing these types of tax strategies would actually increase women's inequality and the 28% gender gap, in terms of encouraging income sprinkling, predominantly to women— if the majority of these corporations are headed by men and if their spouses are women—and that going forward with this would actually encourage that sprinkling to create that low-tax lifestyle, and wouldn't close the inequality and the gender gap.

Again, this is based on testimony I've heard, so I'm curious. Based on the information you and the department have received, can you address some of the claims that closing these loopholes would actually hurt women?

Hon. Bill Morneau: Let me just start with a statement of the values of our government. We want to absolutely make sure that our time in office is one that is very progressive in terms of the ability of women to be successful getting into the workforce, to be successful in the workforce, and to have the ability to manage their lives in a way that enables them to do what they want to do in their careers at the same time as whatever other things they might want to do with their lives. This is a really important issue for us. We will not do anything that will, in any way, impede those overall goals.

For that reason, I am very much in listening mode to the kind of testimony you've heard this morning, but also to other testimony, because we want to make sure we get this right.

We started down this path knowing that the advantages that are available in these incorporated vehicles are ones that are benefiting, for the most part, wealthy Canadians, and benefiting them even more the wealthier and wealthier they get. We took a look at the impact on women, and we were of the view that these measures were not going to have a disproportionate impact on women, but we need to be sure of that, so we are listening.

The kinds of ideas that you heard this morning.... There are some issues. We are going to keep listening. We don't have all of the submissions in yet. We are going to make sure we've heard them all, and we are going to deal with this issue in a way that assures Canadians that our overall goals are met while we also have a tax system that's fairer.

The Chair: Go ahead with a fairly quick question and a fairly quick answer.
Ms. Jennifer O'Connell: I'll quickly talk about some of the testimony we've heard in regard to the health of the economy. The CMA used that terminology, but yesterday, in our pre-budget consultations, we also heard that there are estimates that mental health issues, for example, can cost our economy upwards of $51 billion.

Could we be making better investments to provide health care and those types of services rather than trying to close some of these loopholes that benefit some of the wealthiest?

The Chair: Thank you.

Minister, go ahead.

Hon. Bill Morneau: Our goal, which we've been out talking to Canadians about, is to make sure that people have a fair system that they have confidence in and that it raises the required revenue for government in a way that's fair, so that we have the ability to make investments in places where Canadians want us to and don't leave the burden of those investments on people inappropriately.

The kinds of investments we've made in health care, the commitments we've made to the provinces to increase federal government health care spending, are important. It's going to make a difference. We know it's collaborative with the provinces. The kinds of investments we've made in mental health and in home care are important. We know Canadians see those as important goals.

The tax issue is one that underpins all of that. Making sure the system works so it's fair, but so it creates the business activity we want to create is also important. We have multiple things we need to do at the same time, and the starting point is having a foundational tax system that does not create advantage where none was intended.

The Chair: Thank you, Minister.

Mr. Poilievre.

[Translation]

Hon. Pierre Poilievre: Thank you, Mr. Chair.

Mr. Minister, have you sold your Morneau Shepell shares? If you have, what tax rate was applied to the earnings?

[English]

Hon. Bill Morneau: I'm happy to say that my affairs were fully disclosed to the ethics commissioner, as required, and I continue to work with her to ensure that I am in compliance, which is important. I believe that's—

Hon. Pierre Poilievre: Have you sold your shares?

Hon. Bill Morneau: —an important thing for me to do.

The Chair: Mr. Poilievre, we are trying not to personalize this. This is an important issue. We've heard from 24 witnesses on this issue and they raised a lot of points. I don't believe any of them raised the minister's personal finances, so if we could stick to the issue, we'd appreciate that.

Hon. Pierre Poilievre: It is a deeply personal issue to all the people this government has accused of paying too little tax. It invites reflection. If this is about fairness and about taxing the wealthiest people at a higher rate, can the minister give us even one example of a measure in his proposals that would cause the millionaire shareholders of his billionaire business to pay a penny more?

Hon. Bill Morneau: Mr. Chair, I'm happy to talk about what we're trying to achieve here and recognize that the member may be misunderstanding the after-tax payments that the people get from enterprises, and the money that is parked inside companies.

We're trying to make sure that we have a system that doesn't increasingly provide benefits to the wealthiest. What we've seen—

Hon. Pierre Poilievre: Like yourself.

Hon. Bill Morneau: —over the last 15 years quite clearly is that the ability has grown for people to leave money in passive investments inside their companies.

Hon. Pierre Poilievre: Like your company.

The Chair: Pierre....

Minister, you have the floor.

Hon. Bill Morneau: That ability, which has grown, is not necessarily generating economic activity, and it's also not one that is a similar benefit available to other Canadians. Getting at that we know will make a difference to our tax system to make it fairer, and at the same time it will encourage people to invest in growing our economy.

Hon. Pierre Poilievre: I guess the problem, Minister, is that you say when small businesses save money in their company, it's dead money, but when a big multinational company like Morneau Shepell or Bombardier, for that matter, set aside millions of dollars of so-called passive income, that's just fine and there will be no new taxes on that money.

Can you understand why the owner of the corner store or the family farm is offended that you would impose higher taxes on their savings, but companies like your billion-dollar family business will not pay a penny more?

The Chair: Mr. Minister, the floor is yours.

Hon. Bill Morneau: It's important to understand what we're trying to do here. We know that these incorporated vehicles are an opportunity for people to either invest in their active business, which is very positive for our economy and which we want; leave money within their company for future investments, which is absolutely important for those small businesses, and we have a way to make sure that happens; or put money in a passive investment account, which is allowing them, especially as they get more and more money within their company, to shield more and more money from tax, to defer tax—

Hon. Pierre Poilievre: As your company can do.

Hon. Bill Morneau: —on that investment over time.

The Chair: Pierre, the minister gets the floor.

Hon. Bill Morneau: That benefit is what we're looking at. We're trying to make sure that we have a system that has the right incentives and creates the opportunity for small businesses to thrive, while not creating a large ability for people to defer taxes, which others can't have.

The Chair: Thank you.
Mr. Grewal.

Mr. Raj Grewal: Thank you, Mr. Chair.

Minister, it's always good to see you. We'll jump right into it.

Minister, how many CCPCs do we have in Canada?

Hon. Bill Morneau: About 1.8 million.

Mr. Raj Grewal: Over the last five to 10 years, have you seen a rise in the number of CCPCs in Canada?

Hon. Bill Morneau: The number about 15 years ago was about 1.2 million. In particular, the growth has been among professionals. Over the same time period, we've seen about a 300% increase in those vehicles.

Mr. Raj Grewal: We just heard from the CMA in the last panel. They said that 66% of their members are incorporated, and the balance are employees. Then, when we asked them what the average corporate income was of their members, they said it was $339,000. A lot of their feedback was: “We're going to be upset about income sprinkling.”

Minister, I just want to make sure that Canadians understand that if your spouse or your children are working in your corporation, they will continue to be allowed to do that.

Hon. Bill Morneau: The issue around income sprinkling is very much about making sure that we have a system that doesn't generate advantages that really aren't intended to be there.

If a family is running a business, or if a professional has his or her spouse or children actively engaged in what they are doing, we believe that's really important to continue. We want to make sure that spouses and family members can work, whether it be in a professional office or small business, or on the family farm. That's critically important.

What we're saying—and we're hearing from across the country a lot of understanding of this issue—is that for people who aren't engaged in any way in the professional office or in the small business, they shouldn't be getting income sprinkled just so that the person who is engaged can lower their income and pay a lower rate of tax. That's the goal.

Mr. Raj Grewal: Thank you, minister, for that clarification.

I've heard a lot of feedback in my constituency and as a member in the finance committee. People are really worried about unintended consequences. Particularly farmers across the country are worried. I know our government focus is not on unintended consequences or making the lives of farmers more difficult.

Because these are proposals and we are going through the consultation process, could you please comment on how we will ensure that the family farm is still protected in Canada?

Hon. Bill Morneau: We absolutely know how important farms are to this country and to our food supply, and how important the continuity of the family farm is.

We've heard three things from farmers. We've heard that they want to be able to make sure they can keep their family members engaged in the business. Farmers' families are very engaged. We've heard that. We've heard that they need to be able to keep some money inside their corporation if they have one—not all of them have one—so that they may deal with a down year or the long-term purchase of a piece of equipment. Of course we've heard that it's really important to them to be able to pass their farm to the next generation.

We are listening to those issues. We want to ensure that all three of those issues are considered, because nothing in what we're proposing is intended to change the ability of a family member to work on the farm. Nothing is intended in any way to limit the farmers' ability to save for that investment, whether it be in the next crop or in a new piece of equipment. Nothing is intended to make it more difficult for the farmer to pass the farm to the next generation.

We will listen to these issues, and we will get it right so that those are not concerns. I hope that the farmers who are busy doing what they do right now can take those words and feel some comfort that we're going to get this right so that they are not a disadvantaged sector.

-  (1220)

Mr. Raj Grewal: Thank you, Minister. That's going to give a lot of confidence to a lot of farmers across the country.

The Chair: Very quickly—

Mr. Raj Grewal: Thank you, Mr. Chair. You are so generous with your time.

Minister, can you please confirm again because, in my humble opinion, there has been a lot of fearmongering across the country, that these proposals—and I try to emphasize the word “proposals” because that's what they are—will be implemented going forward and they won't be retroactive.

Another humble suggestion is that the Income Tax Act is very complicated and whatever we end up with, when legislation does come forward, make sure it is clear, fair, and predictable because we don't want to overly complicate things. That's the feedback we're hearing from the committee.

The Chair: If you could give a quick answer too, Mr. Minister.

Hon. Bill Morneau: Just for absolute clarity, we're looking at how the system can work for the long term, so we're looking at future changes. On anything people have saved inside their corporations, the earnings off those savings are not going to be impacted.

The complexity of the tax system is a challenge for many Canadians and our goal is to make sure that we deal with this in a way that is understandable for people. For example, to the extent that families still want to have their family members get earnings from their businesses, we want to make sure that the ability for them to show that is happening is as clear and straightforward as possible. We're going to work to make sure that's the case.

Mr. Raj Grewal: Thank you, Minister.

The Chair: Thank you both.
Minister, I would refer you to testimony that we had this morning from Mr. Lovell, an apple producer in New Brunswick. It was a very heartfelt, emotional presentation, in both the presentation and the answers to questions, on the perception that's certainly out there among the farm community on intergenerational transfers and a number of issues that Raj mentioned around this issue. Could your people definitely look at that?

Mr. Albas, we'll give you about five and a half minutes to balance it up.

Mr. Dan Albas: Thank you, Mr. Chair.

Thank you, Mr. Minister, for coming in today.

Further to Mr. Poilievre's comments, have you read Animal Farm?

Hon. Bill Morneau: I read voraciously. That's a book I have read in—

Mr. Dan Albas: Okay, in that case you would know exactly why many Canadians...because many Canadians have read Animal Farm and in it, one of the statements is "all animals are equal" and then there is a little subparagraph that goes under that which says "but some animals are more equal than others". Mr. Poilievre has presented arguments in the House. He's presented them openly on his website. He's done that here today, by saying that you are actually creating different approaches to passive investments for different types of taxpayers.

Are some taxpayers or corporations more equal than others?

Hon. Bill Morneau: What we are clearly trying to do is to make sure that, as we look at the tax code, the system doesn't encourage behaviour that creates unfair outcomes and that doesn't enable the wealthiest to have bigger and bigger advantages as they get wealthier through advantages that aren't available to other middle-class Canadians.

Based on the evidence, we've identified what we understand to be some very big opportunities for people to plan their affairs and to defer much more tax than would be available for other Canadians. We think it's important to move forward. We think that it will enable us to make sure that our business sector is investing in their businesses and that people can have confidence that the system is fair.

Mr. Dan Albas: Mr. Minister, again, when you do not acknowledge the criticisms, both in the public sphere as well as what happens in the House of Commons, and if you do not acknowledge that these things are there, you are perceived to not be listening.

Some people have described this consultation period that was dropped in the middle of summer as a “drive-by consultation” and people are angry. Are you proud of this approach you have taken or do you have some regret for it?

Hon. Bill Morneau: I'm happy to talk about the approach we have taken to tax fairness. We ran in 2015 saying that we saw that the increase in the number of Canadian-controlled private corporations was driven by the objective of some people to use them as tax-planning vehicles. In budget 2016, we identified the need for expert counsel in order to evaluate where those advantages were. Then we spent the better part of a year looking at what were the biggest opportunities for people for tax planning that were not available to others.

In budget 2017, we identified three measures that we think are critically important to look at and the outcome of that, of course, is where we are now. We have a consultation that's going forward and the good part about that is that we get feedback, so we have draft legislation for two of the measures we are talking about. We're getting feedback. There are important things that we're hearing that will allow us to make sure that we get this right.

We have a third measure—

● (1225)

Mr. Dan Albas: Minister—

Hon. Bill Morneau: —that we don't have draft legislation for yet.

Mr. Dan Albas: —when you don't answer the question, it gets people uptight and angry. Do you regret it?

Hon. Bill Morneau: Clearly, Mr. Chair, we are moving forward on an approach we think is really going to make an important difference—

Mr. Dan Albas: Okay. Now in Kelowna, the Prime Minister said, “Speaking of tax changes, I want to be clear: people who make $50,000 a year should not pay higher taxes than people who make $250,000 a year." We've had tax experts in front of this committee who say that that cannot happen.

Minister, that's misinformation. Who's right here? Is the Prime Minister right, or are tax experts who work with Canadian small businesses every day, with our tax code, correct?

Hon. Bill Morneau: I'm happy to think about some specific examples. Here's a good one.

If you're in our country earning $230,000, and you are a professional, your tax rate would be about 36% if you're not sprinkling income to your family members. If, on the other hand, you're incorporated as a professional and you sprinkle income to a couple of adult children and your spouse, you'll end up with a 20.5% tax rate.

Let's think about what that means. That means for the person at the 20.5% tax rate, they'll take home at the end of year about $180,000 or more. The other person who's not sprinkling income to members of their family who aren't doing anything in the business will instead have about $150,000. These are inequities in our system that we know don't make sense.

Mr. Dan Albas: Minister, your own document says the TOSI, the tax on split income rules—

The Chair: Dan, you will get one more question.

Is that your complete answer, Minister?

Hon. Bill Morneau: I'm happy to have him ask more questions.

The Chair: Okay, you have one more question.

Mr. Dan Albas: In your own consultation paper, it says that CRA is not winning in court enough. On what you said about the TOSI rules—about adult children receiving—we already have rules in place that prohibit that kind of activity below age 18.

But I'd like to ask you one question.
After you did your press conference, the CEO of the Saskatchewan Chamber of Commerce said you owed small business in this great country an apology, because you branded many of them as tax cheats, as people who do not care about the rest of the country, and as somehow freeloaders at the expense of others.

Minister, the floors is yours. Apologize if you feel it's the right thing to do.

The Chair: Mr. Minister, your response.

Hon. Bill Morneau: Mr. Chairman, it's very important that we move forward in a measured way with approaches to our tax system that make sure it's fair. Our approach is to identify things that we think should be considered for the future, and that's what we're doing. The approach people have taken in the past is entirely legitimate. It's based on tax rules that exist.

We're saying that to make sure the system is fair for the long term, we can't allow advantages to grow and grow and grow, and that's what we're doing. What Canadians will see is an increased amount of investment in business across the country. The next generation of entrepreneurs will see a fair system that allows them to be successful, and professionals will have the ability to incorporate for the right reasons. That will benefit all of us.

The Chair: The last questions will go to you, Mr. Fergus. You have five minutes, and we're done.

Mr. Greg Fergus: Thank you, Mr. Chair.

Minister Morneau, thank you for coming to this committee meeting, and thank you for your patience, I might say. You've demonstrated great patience today.

One of the things that I love about being a member of Parliament, and certainly what I love about being a member of the finance committee, is that it affords me an opportunity to learn about things that I would not have otherwise learned. Being a salaryman most of my life, I never had occasion to understand the different aspects of our tax system. My father, who was the sole breadwinner in our family, was in the same situation, so I just didn't have exposure to this.

I have two questions.

First, I'll ask you the same question I've asked other witnesses. Does the tax system we currently have offer advantages to those who are incorporated, as opposed to those who are not incorporated or who are salaried?

The second question is this, and please take the time to explain to me and perhaps to other members of the committee who might be interested in hearing this. What's the difference between the amount of money accumulated in a public corporation and that accumulated in a private corporation? Feel free to get into the weeds.

Hon. Bill Morneau: Considering those two issues, in the first issue around the differences in the tax situation of people with incorporated vehicles versus others, there are some important differences that are there because we are trying to encourage people to start small businesses. The idea that we have the lowest tax rate among G7 countries for small businesses—on average, 14.4% in this country—is an important incentive for people to start a business and take those profits and reinvest them in their business.

The fact that we have a lifetime capital gains exemption for small businesses—a lifetime capital gains exemption that's grown significantly to $835,000—is an important incentive for people to invest in their businesses. There are differences between people who are getting a salary—or people who are unincorporated—and people who are in business. Some of those advantages make really good economic sense. We're trying to encourage behaviour that we know will grow the economy.

But there are some advantages that don't actually, necessarily, encourage the kind of opportunity we want. We don't see as a benefit the idea that people can sprinkle income to adult family members who are not involved in the business just to lower their tax rate. We think other Canadians who don't have that advantage would not see that as one that is actually adding value to our economy. Going forward we're looking at whether that should be continued.

We see that the ability for people not only to have a low tax rate to actively invest in their business but also to create a retirement account inside their business means there's an advantage that isn't really about growing the business. It's about growing a retirement account. Now, I understand that for small businesses that vehicle sometimes makes sense, because sometimes people need the access to those funds on a fairly short time period. We understand that. That's something we've heard from small business and something we're listening to closely.

But for people who are building up a big retirement account just for that exclusive purpose.... We know that, up to about 150,000 dollars' worth of income, it really isn't an advantage for those people, because they can instead use the RRSP and the tax-free savings account vehicles. It's only an advantage for the people who have significantly more income. That's critically important for us to understand.

With respect to the differences between private and publicly traded companies, my experience being in both a private and a publicly traded corporation as a CEO is that what most businesses do when they earn profits is they reinvest them in their business to grow their business, and that's what we want.

When most businesses finish with their reinvesting in the business, they dividend that money out or give it out in salaries. If they are a small business, they pass it out. If they are a bigger business, they dividend it out. Sometimes businesses will decide to leave some money on their balance sheet for reinvestment in the business that isn't the next year. In that case—of course—they're not really doing it for the investment income. They're doing it to invest in their business. The goal they have, then, is to keep that money in their business so that they have a future opportunity.

We're trying to make sure those objectives continue to be possible—invest in your business at a low tax rate, keep money in the business for what's necessary—and also find a way for people to invest in their retirement that creates some sort of inherent fairness in that retirement system, whether they be in a small business, a medium-sized business, or a large business.
We believe all these objectives can be met. We know we'll need to listen to people—we are listening to people—to make sure we get it right. I'm encouraged that so many people are coming forward with ideas on how we can do exactly that.

We'll have much more to say as we finish the consultations and consider the input and how best to get to our objective: a fair tax system that encourages investment.

The Chair: Thank you, Minister.

Thank you, committee members.

I think you're right. There will probably be much more to say on your last words there. Just so you know where this committee is at, we will be forwarding you the testimony that has been put to this committee this week, plus other submissions that will come in on the finance committee's submission button for this issue.

I would say that I think all that testimony was heartfelt. It's easy to recognize that there are a number of concerns out there. There is a lot of support for fair taxation, and I think the bottom line is that people want the government to get it right when they've finished at the end of the day.

That will be forwarded to your office sometime on Monday. With that, we really appreciate your appearance here today.

Hon. Bill Morneau: Thank you, Mr. Chair.

The Chair: The meeting is adjourned.
Published under the authority of the Speaker of the House of Commons

SPEAKER’S PERMISSION

The proceedings of the House of Commons and its Committees are hereby made available to provide greater public access. The parliamentary privilege of the House of Commons to control the publication and broadcast of the proceedings of the House of Commons and its Committees is nonetheless reserved. All copyrights therein are also reserved.

Reproduction of the proceedings of the House of Commons and its Committees, in whole or in part and in any medium, is hereby permitted provided that the reproduction is accurate and is not presented as official. This permission does not extend to reproduction, distribution or use for commercial purpose of financial gain. Reproduction or use outside this permission or without authorization may be treated as copyright infringement in accordance with the Copyright Act. Authorization may be obtained on written application to the Office of the Speaker of the House of Commons.

Reproduction in accordance with this permission does not constitute publication under the authority of the House of Commons. The absolute privilege that applies to the proceedings of the House of Commons does not extend to these permitted reproductions. Where a reproduction includes briefs to a Committee of the House of Commons, authorization for reproduction may be required from the authors in accordance with the Copyright Act.

Nothing in this permission abrogates or derogates from the privileges, powers, immunities and rights of the House of Commons and its Committees. For greater certainty, this permission does not affect the prohibition against impeaching or questioning the proceedings of the House of Commons in courts or otherwise. The House of Commons retains the right and privilege to find users in contempt of Parliament if a reproduction or use is not in accordance with this permission.

Also available on the House of Commons website at the following address: http://www.ourcommons.ca

Published in conformity of the authority of the President of the House of Commons

PERMISSION DU PRÉSIDENT

Les délibérations de la Chambre des communes et de ses comités sont mises à la disposition du public pour mieux le renseigner. La Chambre conserve néanmoins son privilège parlementaire de contrôler la publication et la diffusion des délibérations et elle possède tous les droits d’auteur sur celles-ci.

Il est permis de reproduire les délibérations de la Chambre et de ses comités, en tout ou en partie, sur n’importe quel support, pourvu que la reproduction soit exacte et qu’elle ne soit pas présentée comme version officielle. Il n’est toutefois pas permis de reproduire, de distribuer ou d’utiliser les délibérations à des fins commerciales visant la réalisation d’un profit financier. Toute reproduction ou utilisation non permise ou non formellement autorisée peut être considérée comme une violation du droit d’auteur aux termes de la Loi sur le droit d’auteur. Une autorisation formelle peut être obtenue sur présentation d’une demande écrite au Bureau du Président de la Chambre.

La reproduction conforme à la présente permission ne constitue pas une publication sous l’autorité de la Chambre. Le privilège absolu qui s’applique aux délibérations de la Chambre ne s’étend pas aux reproductions permises. Lorsqu’une reproduction comprend des mémoires présentés à un comité de la Chambre, il peut être nécessaire d’obtenir de leurs auteurs l’autorisation de les reproduire, conformément à la Loi sur le droit d’auteur.

La présente permission ne porte pas atteinte aux privilèges, pouvoirs, immunités et droits de la Chambre et de ses comités. Il est entendu que cette permission ne touche pas l’interdiction de contester ou de mettre en cause les délibérations de la Chambre devant les tribunaux ou autrement. La Chambre conserve le droit et le privilège de déclarer l’utilisateur coupable d’outrage au Parlement lorsque la reproduction ou l’utilisation n’est pas conforme à la présente permission.

Aussi disponible sur le site Web de la Chambre des communes à l’adresse suivante : http://www.noscommunes.ca