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Chair

The Honourable Wayne Easter

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● (1010)

[*English*]

The Chair (Hon. Wayne Easter (Malpeque, Lib.)): If we could come to order, first, on behalf of the committee, my apologies to the witnesses. We had an informal meeting with the Finnish finance committee, and we went a little longer than we thought we would. My apologies for having you stand around outside for a while.

In this session, pursuant to Standing Order 108(2), the committee will do a study of tax planning using private corporations. This will be contributions to the Department of Finance's consultations.

Just to inform you, because the consultations end on October 2, it was decided that we would do hearings with 24 witnesses, I believe it is, and the minister. The minutes, the submissions, and everything you present to us today will be forwarded to the Department of Finance and the minister, without recommendations from this committee. It's to add to the process of consultations.

I thank those who were able to submit briefs. They are on members' iPads. I thank each and every one of you for the fairly quick—super-quick—notice that you've had to prepare and come before the committee.

To start, if we could hold the opening statements to about five minutes, it would be helpful.

Starting with the Canadian Federation of Agriculture, we have Mr. Bonnett, who is the president, and Mr. Ross, who is the director of business risk management and farm policy.

Ron, the floor is yours.

Mr. Ron Bonnett (President, Canadian Federation of Agriculture): Thank you, Mr. Chair and committee members, for the opportunity to share our perspectives on the proposed changes on tax planning using private corporations.

Through its member organizations, the Canadian Federation of Agriculture represents nearly 200,000 farm families from coast to coast. In my eight years as CFA president, it's hard to recall an issue that has evoked so much concern from farmers across Canada. Farmers have concerns with the breadth of the proposals, the limited consultation occurring during harvest, and the immediacy of their coming into force.

The CFA maintains significant concerns with the lack of time to provide feedback on such broad reforms to tax policy. We would be pleased to work with government on improving tax fairness, but such objectives can only be truly achieved through a comprehensive review of Canada's Income Tax Act that engages the broader business community. As such, we have signed on to the Coalition for Small Business Tax Fairness to advocate for a more deliberate and comprehensive process that proactively engages with Canada's small business community.

Today we'll focus our comments on farm sector impacts, but we believe a broader review is still required to address the concerns of the entire small business community.

We were pleased to see Minister Morneau and Minister MacAulay publicly state that Canada's family farms and legitimate farm practices are not the focus of these changes. Despite these assurances, farmers could be hit with unintended consequences, given the tight timeline before final legislation is to be introduced.

Canadian agriculture is evolving at rapid pace. Approximately 25% of family farms are now incorporated, while farms continue to increase in size and complexity. The average age of farmers is now over 55. Succession planning can take years, and many plans will become unusable as a result of these changes, leaving farmers having spent tens of thousands of dollars with little to show for it. The current proposals require significant amendment if legitimate practices are to remain unaffected.

I will now pass it over to our policy director, Scott Ross, to lay out a few of our specific concerns.

Mr. Scott Ross (Director of Business Risk Management and Farm Policy, Canadian Federation of Agriculture): Thank you, Ron.

I'm going to stress that, due to the timeline, our assessment is not yet complete. We continue to hear of new issues and have come together with other farm groups to commission a more detailed analysis of the farm-specific impacts, but this won't be available until October 2. Preliminary results indicate additional tax liabilities well in excess of $1 million on a typical family farm over a 20-year period.

On income sprinkling, we note a few key concerns. Farm families live where they work, and contributions to the farm come about in numerous direct and indirect ways, to which a one-size-fits-all reasonableness test will not do justice. Family farm transfers can take place over decades, with farm children often holding interests in the farm while pursuing an education or working off farm to build skills and diversify revenue. The strict reasonableness test for those between the ages of 18 and 24 creates particular challenges on this front.

Family farms also have access to the farm rollover provisions, which allow for transactions below fair market value. The vagueness in the current proposals creates uncertainty for any assets currently transferred in this manner.

On passive investments, the question remains as to how rented farmland and AgriInvest funds will be treated. Broader concerns persist about farmers' plans for retirement and future investment. The latter would directly undermine the industry's capacity to meet the ambitious growth targets for agrifood exports set in budget 2017.

Finally, changes to the capital gains treatment create undue complications for intergenerational farm transfers. Changes to prevent converting income to capital gains would reinforce inequities the CFA has long noted, which discourage selling family farms to family members. Limitations on access to the capital gains threaten long-term succession plans put in place under the current tax regime, creating additional complexity and costs.

The 2018 special election is also fraught, creating unmanageable tax liabilities through alternative minimum tax treatment and a series of potential tax traps.

Each of these concerns speaks to the potential for significant unintended consequences.

I'll now pass this back to Ron to lay out CFA's views on the path forward.

● (1015)

Mr. Ron Bonnett: In our meetings with Finance, the Prime Minister's Office, and the agriculture minister, it was noted that family farms are not a target of these changes, but we are struck by the magnitude of the changes required and the time available to make those corrections.

We have two recommendations to address the concerns of the farm sector.

The first is that Finance Canada commit to a clear process with farm stakeholders to address these concerns, focusing on, first, exempting legitimate farm income from the new income sprinkling rules because they cannot be applied fairly in the context of a family farm; and, second, exempting qualified farm property because the new rules are detrimental to farm transfers and are inconsistent with current farm transfer tax rules. Finance Canada must extend this arrangement over 2018 to ensure that any unintended or unforeseen consequences following the new legislation can be immediately addressed.

Second, the implementation of these proposals must be delayed until no earlier than 2019, and any transitional rules must be further refined to avoid unintended consequences.

I thank you and look forward to your questions.

The Chair: Thank you very much, Ron. We look forward to that study. I know that a number of farm groups are doing it.

From Canadians for Tax Fairness, we have Mr. Howlett, the executive director.

Dennis, the floor is yours.

Mr. Dennis Howlett (Executive Director, Canadians for Tax Fairness): Thank you for the opportunity to speak to this issue.

One of the challenges with tax policy is that the wealthy have the most to lose or gain, so they are the most vocal. When governments listen only to them, we end up with a whole lot of tax cuts or a tax policy that exacerbates a growing income inequality.

When governments offer tax cuts or close tax loopholes, it's not likely to make much difference in what middle-income and lower-income Canadians pay in taxes. As a result, ordinary Canadians don't speak up, and we've seen the progressivity of our taxes eroded by more and more tax cuts and loopholes that primarily benefit the rich. A recent study by the Canadian Centre for Policy Alternatives found that, on average, the richest 10% get a discount of more than $20,000 a year on their taxes from tax loopholes. That's an increase of $6,000 since 1992.

However, middle- and lower-income Canadians are affected when governments don't have enough revenue to properly fund programs such as child care, public transit, or public services. For example, the Liberal government did introduce day care funding in the 2017 budget, but it was $7.5 billion over 11 years, which the IMF has said is totally inadequate. They are saying that $8 billion a year is what's needed and that the investment would be recovered in increased taxes and a higher labour force participation rate.

Canadians for Tax Fairness has been calling on the government to conduct a public consultation on tax expenditures—what we call “tax loopholes”—and close those that are unfair or ineffective. We welcome the proposed measures to curb the use of private corporations to reduce taxes as a step toward tax fairness, but we urge the government to follow up with closing other unfair and ineffective tax loopholes, such as the stock option deduction, the capital gains exemption, and the business entertainment tax deduction, just to name a few.

We have exposed wealthy individuals using tax offshore accounts and tax havens to evade taxes, and we call for government action to tackle tax havens. We're pleased that some steps have been taken in that regard, but we have never accused those who use private corporations to reduce their taxes of being “tax cheats”. What they do is legal, but that's the problem. Their legal tax avoidance is just as big a problem in terms of loss of government revenue as the illegal tax evasion. It is the government's responsibility to reform laws that do not serve the public good or that are allowing a few wealthy individuals to pay less than their fair share of taxes.

At the root of this issue is inequality. Our tax system has become less progressive over the past several decades and has been a major contributor to growing inequality. The International Monetary Fund and the OECD have determined that the current level of inequality in Canada is negatively impacting our economy. It is slowing down our economic growth. Data shows that inequality also undermines everyone's well-being, including population health outcomes, even for the rich.

Stagnant incomes of middle- and lower-income Canadians reduce the consumer demand for goods and services that business depends on. In fact, the Canadian Federation of Independent Business survey of its members in 2015 found that the main factor limiting the ability of small businesses to increase sales or production was insufficient domestic demand. Their biggest problem is not the tax rate, but the lack of purchasing power of Canadians. They would benefit from government policies to boost aggregate demand, such as raising minimum wages, investing in day care, and investment in other social and physical infrastructure.

Our tax system is also one of the best tools that could be used to help reduce inequality by raising revenue that will enable governments to invest in programs that will help reduce inequality and also curb unfair and ineffective tax expenditures that exacerbate income inequality.

● (1020)

The research clearly shows that the wealthy are far more likely than middle- or low-income Canadians to own a private corporation, and the wealthy are far more likely to take advantage of these tax loopholes. Fewer than 10% of those with incomes under $51,000 have a significant interest in a private company. For the top one-percenters, about 50% own a significant interest in a private company. For the top 0.01%, the number rises dramatically to almost 80%.

This isn't just a small business issue. Two-thirds of Canadian small business owners are earning less than $73,000. For them, this tax loophole really doesn't provide much benefit at all. It's not much help for start-up businesses, because they don't make much money in the initial years. Also, small businesses have other options to save for retirement. The RRSPs and the tax-free savings accounts are already benefiting from very generous government subsidies.

The Chair: We're a fair bit over. Could you wrap up fairly quickly?

Mr. Dennis Howlett: My point is that this is an important step forward in tax fairness and it should not harm job creation or the economy as a whole.

Thank you.

The Chair: Thank you very much, Dennis.

We'll turn to the Coalition for Small Business Tax Fairness, with Mr. Kelly, president and CEO of the Canadian Federation of Independent Business—I believe we saw you just the other day—and Mr. Wonfor, national tax office leader, BDO Canada.

The floor is yours.

Mr. Daniel Kelly (President and Chief Executive Officer, Canadian Federation of Independent Business, Coalition for Small Business Tax Fairness): Thanks very much. John and I will share the presentation.

I did wear a different suit this week, Chair, just to try to throw you off, but it didn't work.

I am here today not in my capacity as head of the Canadian Federation of Independent Business, but as a member of the Coalition for Small Business Tax Fairness. This coalition started less than a month ago with 35 business associations coming together to raise their concerns over these issues and now has grown to over 70 business associations across the country, representing hundreds of thousands of Canadian employers and millions of Canadian employees.

The coalition members are listed in the deck that I presented to you and include members from construction, agriculture, professional services, retail, and restaurants. All of those groups came together to try to express concerns to government about these proposed changes.

By way of background, I'm very pleased to hear that those who are in favour of this legislation—government—and those who are opposed have agreed that the vast majority of small firms have fairly modest levels of income. Two-thirds have under $73,000 in income. I'm very pleased that we're not getting into a debate over that.

Our point has been that business owners at all levels of income potentially will be affected by at least one of the three measures in this package, including those who are earning well below $150,000 per year, a number that was put out by the minister.

Many of these businesses, if not most, will also find that their tax burden will increase. That's something that I think we need to make sure government knows. For for the majority of business owners, their overall aggregate level of taxation that they will pay as a result of these changes will be higher in the future, obviously meaning less money for the other things that we may view as important.

Also, through these changes, there many examples, which the coalition is illustrating, of where Canadian business owners will pay higher rates of taxation than other taxpayers at similar levels of income. This isn't just about making small business owners pay the same. In many cases, we find that business owners will pay more. Of that, there seems to be no question. All of the reviews by tax professionals have suggested that there are many examples where business owners will pay more than other taxpayers at similar levels of income.

On income sprinkling, this has the potential of affecting all taxpayers at almost all levels of income. Really, at the income level of about $50,000, business owners will start to be affected by these changes.

We are also deeply concerned about the lack of clarity of the enhanced reasonableness test that will be used by the Canada Revenue Agency.

With respect to passive income rules, many businesses do have requirements to retain earnings in the corporation or policies that limit the amount that can be distributed to their shareholders. Many businesses incur losses in their start-up years that the shareholders just can't use to offset against personal income. We also want to note that successful businesses, particularly in the high-tech sector, use these retained profits in the corporations to invest in other start-up businesses, so that source of financing for other businesses, we worry, will start to dry up.

While some have suggested that an enhanced use of RRSPs or TFSAs may be a solution for business owners, there are the practical limitations of this. Your policies will encourage business owners to take more money out of their businesses, leaving less money in their businesses to protect them against economic downturns or problems in the business, or to invest in future business opportunities.

I'm going to turn things over to John to take it from here.

● (1025)

Mr. John Wonfor (National Tax Office Leader, BDO Canada, Coalition for Small Business Tax Fairness): Thank you very much for this opportunity.

Dan has asked me to speak to two slides here. The first slide is comparing the tax on passive income between the current and the proposed rules. I want to make a couple of points with respect to that.

There's no question that the proposals will substantially increase the tax on passive income earned inside a private corporation where the source of the funds benefited from a tax deferral that the corporation offers. Basically, what the proposals will be doing is trying to tax back, to claw back, the advantages of that deferral. The tax rates on this slide, I think, are not in dispute. A lot of tax professionals have gone through them. There are substantial—

The Chair: Excuse me. I have to interrupt for a second. We will soon start to run out of time. People do have the slide. It's page 8. People have been given a copy.

Go ahead.

Mr. John Wonfor: Thank you, Mr. Chair.

I don't think the tax rates on this slide are in dispute. They show the substantial increase in the tax costs for these types of passive income.

I think the question here, the policy question that really needs to be examined, is whether a deferral is appropriate tax policy for Canadian private businesses. We believe there are good reasons for why this is appropriate tax policy. Dan has already alluded to some. I want to add two points to that.

I think a source of savings inside a corporation ensures a pool of capital available to invest in the business. Those types of substantial investments can happen only every few years, particularly for a smaller business. I think it's very important that they're able to save these funds to have access to that.

Second, these types of savings can help businesses through years in which income fluctuates or through economic downturns. We had a lot of clients in our firm—for example, those in Alberta—who, during the recent economic downturns, used their savings in private corporations to maintain employment levels in the Alberta market, where larger corporations had a lot more layoffs than the private business sector did.

Moving on to slide 9, I have a couple of comments with respect to the impact of the changes to intergenerational transfers. I have a couple of comments with respect to the impact of the changes intergenerational transfers. I want to make a couple of points to help you understand that the tax cost of intergenerational transfers will increase, and increase substantially, under these proposals. They're going to increase for a number of reasons. You can see that this slide talks about the tax cost increasing by as much as 70%. Let me explain that for a minute.

Many intergenerational transfers are structured so that parents pay capital gains tax on the sale of shares to their children, even forgoing the capital gains exemption, the ability to claim that exemption, and allowing the children to use the future profits of that business to pay back the parents. The changes are effectively going to change the tax cost on that type of planning from a capital gains rate of approximately 27% to the tax rate that applies to dividends, which is 45%. Do the math. It's about a 70% increase.

By selling to an arm's-length party, the business owner would only have to pay tax at a capital gain rate of 27%, and if they added a capital gains exemption there, they could lower that rate even further. There's a bias now being created towards an arm's-length sale of the family business over intergenerational transfer.

In the interests of time, I'm going to stop right there, but we do have other examples to show how the answer is even worse if the new rules for splitting income apply.

● (1030)

The Chair: Very quickly, go ahead, Dan.

Mr. Daniel Kelly: To conclude, tomorrow we're sending a letter to all MPs on behalf of the coalition. It is directed to the Minister of Finance. The purpose of the letter is to challenge the assumptions and the justification being used for these particular changes.

It is highlighting—and showing the evidence from almost all private sector tax professionals—that business owners will pay more as a result of these changes, that in many cases they'll pay more than will other personal taxpayers, and that this will disproportionately affect women. Finally, it will ensure that the changes are focused on middle-income small business taxpayers, not just those at the high end.

Thank you.

The Chair: Thanks to both of you.

We turn now to Unifor president Jerry Dias and Ms. Tiessen, national representative, research department.

Mr. Jerry Dias (President, Unifor): Good morning. My name is Jerry Dias. I am the national president of Unifor, Canada's largest union in the private sector.

We represent over 315,000 working people from coast to coast to coast. Our members work in every sector of the economy and are represented at every income level. Our members pay their taxes and contribute in multiple ways to building a society that we want to live in every single day.

On behalf of our members, their families, and their communities, I am pleased to provide our views on the fair taxation of income of CCPC owners in Canada.

Unifor advocates for and supports a progressive tax structure that ensures our governments at all levels have the revenue necessary to provide high-quality, efficient, and effective public services. That tax structure also needs to acknowledge the income and wealth inequality present in our society today and ask those who earn more to pay more.

Taxes pay for the basic services that we rely on every day, from health care to infrastructure and to addressing some of the most pressing needs of today, including poverty elimination, reconciliation, and leadership on the environment. The issue we're discussing today is an inequity in our tax system that allows some people to opt out of paying their fair share of the revenue governments need to pay for those services.

The Government of Canada is proposing to close some tax loopholes that allow incorporated small business owners to avoid paying the same amount of tax on their income as an earner who works for employment income and makes the same amount of money. Sixty per cent of the top 0.1% of income earners in Canada own shares in a CCPC. Only 5% of middle-income families do the same. That means that 60% of those who earn the highest incomes in Canada have the ability to opt out of our progressive tax system through these loopholes, while the rest of us have been paying our fair share all along.

Most small business owners do not benefit from these loopholes either. A business owner has to have a very high income and a particular family structure in order to accrue significant benefits from the loopholes that are being discussed, but two-thirds of small business owners make less than $73,000 a year. Most small business owners do not earn enough money to exploit the loopholes.

Unifor supports the government's initiative to increase fairness in the income tax system by closing unfair tax loopholes: loopholes that are currently available to high-income earners who have incorporated a small business, but not available to people who work for a salary or wages, both high- and low-earning. The result of exploiting these loopholes means that some earners have higher disposable income or a larger investment portfolio than others simply because of the structure of their business.

The loopholes under scrutiny today have meant that two earners with similar incomes, and in a similar family structure, one with a CCPC and one without, will pay two very different effective tax rates. Those differing effective tax rates result in two very different levels of disposable income today, and two very different levels of savings in the future.

We know that the tax benefits of these loopholes accrue to the highest-earning CCPC owners. Furthermore, the research from virtually every economist and policy expert who has weighed in on this subject has found that the benefits of the tax loopholes only accrue once a CCPC owner's income has surpassed a certain level. Income splitting, for example, does not provide a significant benefit to anyone making less than $90,000.

Business associations and other advocacy groups have tried to paint the proposed changes as a tax grab on the middle class. This is not the case. The tax changes will lead to more high-income earners paying the same tax rate as their salaried and wage-earning peers. Where this issue does affect the middle class is in ensuring that income earners in the same income decile before tax are in the same income bracket after tax.

Business associations and other advocacy groups have tried to paint the proposed changes as a drag on investment, innovation, and entrepreneurship. The reality is that these tax loopholes have very little to do with innovation or business investment. Governments can and should develop systems that support innovation and business investment, but the current system is one that incentivizes neither.

This proposal is about protecting the integrity of Canada's progressive tax system. Canadians believe in paying their fair share of taxes. While there is more to be done, this is certainly a step in the right direction.

Thank you.

● (1035)

The Chair: Thank you very much, Jerry.

Mr. Milligan, professor of economics at the University of British Columbia, the floor is yours.

Mr. Kevin Milligan (Professor of Economics, University of British Columbia, As an Individual): Thank you very much, Chair, and thank you, members, for convening the meeting.

I'd like to make two quick points this morning. The first one is about the goals of the reform, and the second one is about the implementation of the reform.

As I see it, the main goal of the reform is to push towards neutrality of the tax system. A neutral tax system is one in which business decisions are made based on business merits and not pushed one way or the other by the tax system. That's a free market principle, and I think it's a good one.

The current tax system fails neutrality in a number of ways. Let me give you an example of the way our system fails neutrality right now. Imagine someone who has some skills, a hammer, and a truck, and she wants to start a business for herself. She talks to her friend who's an accountant and who says that it doesn't make sense for what she's doing to incorporate. For business reasons, her friend says, she doesn't need to do that at the income level she has at the time.

The problem is that she has to compete out there with people who are incorporated and who get a whole bunch of tax benefits that she, as an unincorporated person, does not get. What this does is create a barrier to starting up a business. There are a lot of businesses out there, a lot of people with a whole bunch of entrepreneurial spirit, who are not incorporated. They're equally hard-working, care equally about their families, and equally help out the economy. We want to make sure that the balance between incorporated and non-incorporated business is there. That's what I mean by neutrality.

The second point is about the implementation of these reforms. Many tax practitioners have raised a number of concerns about things such as succession planning, intercorporate holdings, and also the exact transition rules for the passive income measures. In these complaints that we've heard, or these suggestions that we've heard, there are a lot of interesting and useful suggestions. What I hope we see is that the finance minister and the Department of Finance, after October 2, are able to respond seriously and thoughtfully to the concerns that have been raised.

I do think these things should be taken seriously; however, I don't think we should stand frozen in inaction because of fear of some transition costs. Tax changes always require transitions. They always require some disruption. I'm pretty sure that in 2019 members from parties around the room here are going to have some tax proposals they want to bring forward, and every single one of those tax proposals will involve some transition and some changes.

What I think is the right way forward is to balance off the cost of those transitions and the complexity that might arise with the benefits you get from pushing towards a goal that we think is important. That's the way I think we can build a better tax system for Canada.

● (1040)

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

We welcome Mr. Lanthier, who is a retired partner of Ernst & Young and former chair of the Canadian Tax Foundation, testifying as an individual.

Mr. Allan Lanthier (Retired Partner of Ernst & Young and Former Chair of Canadian Tax Foundation, As an Individual): Thank you, Mr. Chair.

I'd like to thank you and the other committee members for inviting me to appear today to address this important issue.

I'll restrict my opening statement to certain aspects of the passive income proposal. The proposal is contentious and would result in significant harm to our Canadian economy, and therefore to the middle class, which depends on that economy.

A Canadian-controlled private corporation, or CCPC, is, as you know, taxed at preferential rates on business income. The government is concerned that a CCPC that acquires portfolio investments therefore has a deferral advantage that is not available to individuals.

The government’s concern has merit. Investment income of private corporations increased from $9 billion in 2002 to $27 billion in 2015. The government’s proposal would tax the investment income of a CCPC at a non-refundable rate of 50%, equal to the assumed highest personal tax rate for individuals, the so-called one-percenters. Then there would be a second tax when the corporation pays dividends to its owner. The result would be a combined tax on investment income of more than 70% for business owners in the highest rate bracket.

The impact on middle-class business owners would be even worse. While middle-class owners are not the real target, by using a non-refundable corporate rate of 50%, the proposal would severely overtax every business owner in this country who is in a rate bracket below the top rate. For example, a middle-class owner who is in the 30% bracket would suffer a combined rate of 59%, not 30%. That's a 75% increase over existing law. Canada already imposes an immediate tax of 50% on the type of income we're talking about here. That is more than enough. There are about 200 countries in world. There is only one country in the world that has a corporate tax rate above 50%.

Still, the amount of investment income of private corporations is increasing. Why is that? Outside of the professional sector, there is no reason to believe that businesses are incorporating for tax advantages. A business incorporates for a number of non-tax reasons, and none of these have changed in the last 50 years.

Professional income is quite different. Many high-rate doctors, lawyers, and accountants, including many partners of large national legal and accounting firms, are incorporating solely for tax benefits. This is certainly the major cause of the recent increase in the amount of investment income earned by private corporations.

I therefore suggest a different approach: the introduction of a special refundable tax for professional income of a CCPC for most medical doctors, lawyers, and accountants. This tax would be similar to the tax that was enacted in 1979 and repealed in 1984 for mechanical reasons, not tax policy reasons. The tax would not apply to any other industry sectors, so it would address the government’s concern but avoid most of the economic damage that applies under the current proposal. It would be simple and understandable, and the revenue from the tax could be easily and accurately tracked. All additional tax revenue from incorporated medical doctors should be earmarked for health care funding, and the balance for debt reduction.

Mr. Chair, I am a retired accountant. I have no clients. I hold no interests in private corporations or in any trusts. I have no dog in this fight. I simply want to see tax changes that address tax policy concerns, but that do so in a sensible and thoughtful manner, and that strike an appropriate balance between tax revenue for the government and the inevitable damage to our economy that any additional taxes cause. As part of this process, we also need a comprehensive review and reform of the taxation of private corporations.

Thank you, Mr. Chair.

● (1045)

The Chair: Thank you very much.

Thanks to all our presenters. There is no question that we have the full width of the debate, and I thank everyone for their directness.

We'll go to five-minute rounds so that we can get more people on and more questions, starting with Mr. Fergus.

[*Translation*]

Mr. Greg Fergus (Hull—Aylmer, Lib.): I thank all of the witnesses very much for their presentations. I learned a lot from them.

One of the privileges members of Parliament have is that they can learn things about topics they never examined before.

I am the son of immigrants. When my father arrived in Canada, he worked, and my mother stayed at home. My father always received a salary, so his income tax returns were not complicated. I also earned a salary during all of my career, and so my tax returns were not complicated either.

Since this summer I have had the opportunity of learning a lot about the private companies controlled by Canadians.

[*English*]

I have a very specific and quick question for all of you. I'd appreciate it if you could keep your comments to 15 seconds in terms of an answer. It's a pretty direct question.

Does the current tax system offer tax advantages to Canadian-controlled private corporations that are not available to salaried workers, to salaried men and women like me?

Mr. Lanthier.

Mr. Allan Lanthier: Mr. Chair, I thank the member for his question.

Salaried employees are absolutely taxed differently than owners of small business. I think the only policy issue here is whether individuals incorporate solely or primarily for tax purposes.

Mr. Greg Fergus: I got that. I just want to know what the current system is. I'm trying to get my head around it.

Mr. Milligan.

Mr. Kevin Milligan: Yes, I think it's a good question. I think there are clear advantages for those who incorporate.

I think the right comparison is not necessarily to think about a regular salaried worker versus a small business person, but again, within the business sector, those who are incorporated versus those who aren't. Within the medical sector, 40% of doctors who are not incorporated. Think of them, who trained just as hard as everyone else, and compare them to those who are incorporated.

Mr. Greg Fergus: Monsieur Dias or Ms. Tiessen.

Mr. Jerry Dias: The answer is yes. The bottom line is that we have a structure in place where doctors, based on a tax loophole, pay less than registered nurses.

Mr. Greg Fergus: Okay. I'm not going there. I just want to get an understanding—

Mr. Jerry Dias: But I am. I did.

Voices: Oh, oh!

Mr. Greg Fergus: Mr. Wonfor or Mr. Kelly.

Mr. John Wonfor: Yes, there are some tax advantages with respect to Canadian-controlled private corporations. I think the key here, though, is that we're in favour of a comprehensive tax reform to determine what is the right tax policy to support Canadian businesses, to be fair and also to get tax simplification—

Mr. Greg Fergus: Okay. I got that.

I'm sorry. It was a quicker question.

The Chair: The witnesses have the floor, Mr. Fergus.

Go ahead, Mr. Howlett.

Mr. Greg Fergus: I'm sorry, Mr. Chair. I'm just concerned about the time I have left. I want to make sure—

The Chair: I know. You asked all of them to answer and they'll answer.

Mr. Howlett.

Mr. Dennis Howlett: Yes, there are big advantages.

Even going beyond what already exists for small businesses, Canadian taxpayers are already subsidizing the lower small business tax rate by $3.6 billion. Above that, there are additional benefits—probably about $1 billion—that go just to the private corporations.

● (1050)

Mr. Greg Fergus: Mr. Ross or Mr. Bonnett.

Mr. Ron Bonnett: I think the question should be about the balance of what a salaried employee gets and what a business owner gets. If you're working for a salary, you'll have benefits and a pension plan. You'll have an employer who takes care of all the risk. If you're a small business owner, you have a number of risks that you have to deal with. Even more importantly, as a farmer, you have weather risks that other groups don't have to contend with. You also have to make sure you have the investment income and the ability to create those jobs.

I think it's very difficult to compare a salaried worker to a small business person, because there's a different scenario. Before I started farming, I worked for a large corporation and everything was covered. I didn't lose any sleep at night. Working as a farmer, you're losing sleep, you're worried about employees, you have a number of things you have to manage, and some of these tax policies give us tools that we can use.

The Chair: You can have a very quick question, 30 seconds at the most, and a 30-second answer.

Mr. Greg Fergus: First of all, thanks very much to all of you for answering that question.

I think generally there's a consensus that there is a tax advantage that is offered to an incorporated versus non-incorporated person. I do appreciate that. I also appreciate the particular case of farmers, who are concerned not just about that but also all the other factors that go into being a successful farmer, which we all need.

I don't have enough time to go on. Thanks to all of you for answering my questions.

The Chair: Mr. Poilievre.

Hon. Pierre Poilievre (Carleton, CPC): Well, the answer is that there is no advantage to incorporation in a tax sense, because of course all income earned within a corporation is taxed at exactly the same rate as it is in the hands of a salaried employee, just at a different time. Small businesses pay 15% up front, and then they pay the balance of their tax owing on distribution.

So no, there is not an advantage. There is a different circumstance in that salaried employees don't need to keep capital in a particular enterprise, because their enterprise is their employer, which is separate from their own holdings.

My question is for Dr. Milligan, an economist for whom I have great respect.

I do want to politely challenge one of your assertions. You said that we need a neutral tax system. I think most people agree that we need more neutrality. These changes are being sold as though they are turning our tax system more into Switzerland—neutral—but there are examples of the contrary.

The passive income measure will mean that a business will pay higher taxes when investing in another business's operations than it pays when investing in its own. This is a bias further compounded by the fact that publicly traded companies will not face these higher tax rates on passive income held within the corporation, nor will their shareholders.

Finally, amendments to section 84.1 and the creation of proposed section 246.1 would make a family farm or a family business pay higher taxes to sell its enterprise to the children rather than to a stranger.

These are examples of where these proposals would seem to render the tax system less neutral, rather than more neutral. How would you respond to those matters?

Mr. Kevin Milligan: I thank the member for the question. There are a couple of things.

First, I think it's great that we can agree on the principle of neutrality as being an important goal to strive for. I think that is the right goal for our tax system: to make sure that it encourages growth and also is fair to all Canadians. I think it is a good goal. It's good to identify places where the system is not currently neutral. We could have a very long discussion about all the ways that's true.

The member has identified some important issues that may be challenges with the current proposal, those being the intercorporate holdings, the secession planning, and other elements that may lead to situations in which people in seemingly similar circumstances face different tax situations. These are some of the concerns that I hope are addressed after October 2, when we hear the response from the Minister of Finance. I encourage the member to continue those questions when we see that response.

The second point I'd like to make is about the small business deduction. I have raised that because it's kind of the core of the non-neutrality that we've have introduced, which is that we have a different tax rate for some kinds of businesses than for other businesses. One way we could get got rid of that would be to remove the small business deduction entirely.

Now, that might be something a lot of people would have a challenge with. Back in 1971-72 when this was first introduced, that was the exact nature of the discussion. We were going to have a small business deduction because we liked to encourage growth in small businesses. The challenge we faced, though, is how to make sure we focus those efforts on these small businesses to grow their businesses and the economy, and not use it as a place to accumulate savings away from taxation.

● (1055)

Hon. Pierre Poilievre: Mr. Chair, I thank the good gentleman for his comments on the small business deduction. My question, though, was related to the new biases and the new inconsistencies that are now created by this tax change.

I want to give the Coalition for Small Business Tax Fairness a chance to comment on this, because, again, the academic or esoteric argument in favour of this proposal is that it's going to create more neutrality, but I've have just given three precise examples of where the system will in fact become less neutral and more biased, and where different taxpayers of the same income level will be taxed at greater disparities than they are right now.

Can you comment on that, Mr. Kelly or Mr. Wonfor?

Mr. Daniel Kelly: Yes. I think that's certainly the case. We are deeply worried that this is going to create a whole...it is mixing up the Canadian tax system for businesses and turning it on its head after about 40 years, with very limited.... I appreciate that there is some consultation, but it's very limited consultation for the size and scope of the changes that are being proposed.

I have to say that there are some, particularly in the academic community and many in government, who seem to think or feel that they can divine which businesses are going to be the ones that are going to be successful or grow rapidly, and that we should shower them with support. I get and appreciate the intention and the goals they have. Many in government have said that they want to support small business, but just in different ways: by picking those small businesses that are going to be successful and helping them grow the economy. It's just that there's zero track record of any government agency or academic set of criteria that will help governments or others do that.

Our view is that the only way we can do that is by truly being neutral and ensuring that there are broad-based supports like the ones that currently exist and, of course, the additional supports that were promised by the government: to reduce the small business rate to 9%.

Hon. Pierre Poilievre: Yes, and you—

The Chair: Sorry, Pierre. Your time is up.

Mr. Boulerice.

[*Translation*]

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

I also thank all of the witnesses for having enlightened us on this topic and having provided us with more information. Although the information provided by witnesses is sometimes contradictory, I expect that their research was well done. It will be up to us to sort it all out.

May I remind you that during the last election campaign, the current Prime Minister made a rather unusual statement. In his opinion, many people were creating small and medium businesses in order to avoid paying their fair share of tax. We could say that the Prime Minister was speaking from experience, since that is something he did himself on several occasions. Indeed, he created four numbered companies in order to reduce his income tax rate. His comment poisoned the atmosphere to some degree. Still today, many SME owners consider that this does not correspond to their reality.

The Liberals had also promised to reduce the income tax rate for small and medium businesses from 11% to 9%. This was not done, however. In the 2015 Liberal platform, no mention was made about targeting small and medium businesses in particular. However, the Liberals said that they wanted to eliminate the tax loophole that benefits CEOs and allows them to save about $800 million, money we lose which could allow us to improve social programs or our infrastructures.

Mr. Dias, earlier you said that you were in favour of reducing tax unfairness between salaried workers and small businesses that can choose to incorporate. However, you also said that we could do more than that.

In your opinion, does doing more mean that we should target the tax loopholes that benefit CEOs, as well as the proliferation of agreements with tax havens?

● (1100)

[*English*]

Mr. Jerry Dias: I do not agree with tax havens at all. I mean, take a look at the Panama Papers and follow that whole stream. I paid $53,000 in taxes last year. I don't quarrel with that at all. I'm not looking for a mechanism with which to reduce it. I enjoy the social programs here, as does every other Canadian. I want to make sure we have enough money for infrastructure spending to create jobs.

Look, I believe in tax fairness, period.

[*Translation*]

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

Mr. Kelly, in the Liberal Party's 2015 electoral platform, the Liberal Party stated that it wanted to "conduct an overdue and wide-ranging review of the over $100 billion in increasingly complex tax expenditures that now exist".

I agree with the Coalition for Small Business Tax Fairness on the fact that that consultation was too short, aside from having been conducted in the middle of summer, and that it only covered part of the reality, whereas we were promised a wide-ranging review.

I agree with your last recommendation. If a tax reform is to be conducted, should we not review all tax measures, rather than targeting only one economic sector? In your opinion, should we not also review all of the regulations, not only the ones that apply to small businesses, but also to multinationals, large companies, CEOs, as well as the tax agreements we have with certain tax havens?

[*English*]

Mr. Daniel Kelly: Yes. In fact that has been our exact recommendation.

Look, I get and respect that there are challenges. There are situations, including the situations affecting Canadian-controlled private corporations, where a government may need to tighten some of the rules. We've never suggested that this is unfair. We didn't freak out, in fact, when the government first talked about making some changes to that. Neither did we reject out of hand the proposals when they first came out—until we studied the potential impact of these changes on the broader business community. We are 100% on board with working with government to ensure that all parts of the Income Tax Act are tightened to ensure that abuses are not allowed, including those aspects for Canadian-controlled private corporations. We just feel that this is the wrong way to do it, with tight consultation....

I want to say one thing that I didn't get to say before. The letter we're sending to you as parliamentarians tomorrow has detailed analysis by almost every accounting agency in the country to outline the concerns that we are expressing, to prove to you that these changes have a much broader impact than the government, I believe, thinks. We're hoping that you'll pay close attention to that when it's delivered tomorrow.

The Chair: Thank you very much. We look forward to that analysis.

Ms. O'Connell.

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

Thanks to all of you for being here. I could ask each and every one of you a question, but I have limited time so I'm going to start with Mr. Bonnett or Mr. Ross.

First, let me thank you for the recommendations you put on the record. Those constructive recommendations are actually helpful, because this is a consultation period to make sure there aren't unintended consequences.

In terms of my colleague's earlier question about the advantages and inequities, I want to ask a question. Even amongst incorporated farmers, let's say.... I had my first job when I was 16. It was not in a small business, but the idea is that a lot of young people work when they're 16 or 17. In an incorporated small business with a child of that age whose parents own a farm, say, those parents would not be able to sprinkle income. In comparison, a farm maybe right next door with children who are 21 and working in the business has a very clear advantage of being able to sprinkle income.

Both are legitimately working on the farm, but one has a sprinkling advantage that the other doesn't. Can you not acknowledge the fact that even within incorporated businesses this arbitrary age for sprinkling creates some inequality that should at least be reviewed and determined?

Mr. Ron Bonnett: I think what I would say is that there are inconsistencies in the tax law. In our presentation, we talked about having a thorough review. I think what's unfortunate is that these proposals came down in July and there wasn't really time to analyze them. That's why we agree with the coalition for small businesses. If we're going to look at tax changes, we really have to look at them thoroughly and do some analytical work.

I mentioned that we're having a study of our own done with the agricultural community. When you change one piece of tax code, quite often it will end up bumping something down the road someplace. That's why you can't have a major tax policy change like this one take place over a very short period of time. It has to be almost a discussion paper that is engaging with the small business community to just take a look at some of the inconsistencies that exist, as opposed to the inequities.

Scott.

● (1105)

Mr. Scott Ross: I would say that I think in regard to the example you use, where a farm child is actually working on the farm, the discrepancy you note between the two I don't think in reality would actually take place. If someone is legitimately working on a farm, we would hope that even under the reasonableness test.... I think there are a number of elements of that test that are currently quite vague and that we have very significant concerns with, but under any sort of reasonableness test, we would hope that anyone legitimately working in a farm business is able to receive income for the work they're undertaking, regardless of whether they're a child of the farm family or a salaried employee.

Ms. Jennifer O'Connell: Right, but as it exists now, you can't sprinkle other than for a specific age group, so there's legitimate reasonableness in terms of paying someone, but in terms of the sprinkling, there's an age limitation. I appreciate the comments in terms of an overall review, but I have to move on only because I have limited time. Thank you.

Mr. Milligan, I was interested in your comments that were reported in the media. In particular, Global News wrote about your comments in terms of the 73% number. In the Conservatives' internal briefing that was released by VICE News, they talk about really focusing on the 73%. They say not to hung up on the wealthy individuals, because that's not the message they want to attack the Liberals on.

It was interesting, because you were asked, I'm assuming, in this media report, to comment on the 73% number. What's reported is that you clarified that there would be only a very specific case or cases that would actually equate to 73%. That's certainly the messaging they want to counter: to not focus on wealthy individuals but the middle class. Can you comment on that 73% number and the scenarios that it really matters in?

Mr. Kevin Milligan: Sure. Thank you for the question. I am an academic, so I'm going to start at the principles, but then I'll get into the specific example.

The principle here again is one of neutrality. We want a tax system that doesn't either favour or disfavour saving inside the companies. What this means is that we have to compare the taxation of savings inside a company with savings outside a company.

Right now, because of that small business deduction, there is an advantage for saving inside the firm. What the proposals do is try to peel back that advantage by imposing an extra tax inside the firm. That's what it does to balance the saving inside and outside the firm.

Now, to do that, one has to impose this extra tax inside the firm, and this is where you get numbers like the one that you suggested for particular circumstances. For example, if you're a high-bracket Ontario taxpayer who already has $220,000 of other income, your extra tax that you would pay, should you flow through your passive income, would be in the range you've suggested, but that's not something that's universal.

I can take another example, which would be that of someone who's making $50,000 as a small business person and immediately flows it through to their pocket, because they're not saving big pots of money: they're trying to feed their family. That person faces a tax rate of about 30%, whether it's taken through dividends or through employment. That's the kind of thing that I think matters to most small business people.

In thinking about what is the taxation of a big portfolio of hundreds of thousands of dollars of assets, we have to get that right. We don't want to do that unfairly, but I don't think that's the main focus for most business people.

The Chair: Mr. Albas.

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

Thank you to all of our witnesses. We certainly appreciate your input on this important measure.

I'm going to start with you, Mr. Milligan, since we're both British Columbians and proud to say that. I would like to go back to your example of a woman with a truck and some tools getting out there. I haven't been in construction, but I've been in the industry, where you start off as a sole proprietor. Then you find a partner. In British Columbia, it's six months, and you're considered common law.

Let's say your common-law partner has a condo. You are liable not just for what you do on the job, but also, you can be sued if you drop a hammer on someone, and suddenly your partner's assets come into play. That's something that employees don't have to consider. Is that correct?

● (1110)

Mr. Kevin Milligan: It's most likely correct. I'm not an expert in law, but I don't expect that the liability would lie on an employee in such a situation.

Mr. Dan Albas: Okay. Let's say that five years into it she doesn't have a spouse or whatnot, but she does have a child. She's been putting aside money for her child's RRSP. Again, she drops a hammer at work and gets personally sued, and suddenly that RRSP can actually be taken away through a court process. Is that the same kind of thing? Would that happen to a salaried employee?

Mr. Kevin Milligan: Again, for a salaried employee, I'm not an expert in the law, but it's my view that a salaried employee would face different legal obligations than an employer.

Mr. Dan Albas: Again, she decides that she's going to expand her business and hire someone, who then drops a hammer on someone. Because now she's vicariously liable for that, her house can be seized in a lawsuit. Is that the same as it would be for someone if they were simply an employee?

Mr. Kevin Milligan: Again, these are special legal distinctions between those who are incorporated and those who aren't, and those who are employees and those who aren't. Those are clear distinctions.

Mr. Dan Albas: While I totally understand your argument on tax neutrality, you also have to acknowledge that the entrepreneur is working within a business reality. Again, the reason why more and more people are incorporating may be for the simple reason that they want to protect assets because they want to look after their family.

I also wanted to talk to you a bit about.... I have to thank you for your work on Twitter. I think it's wonderful that we have many economists who broadly put out their work on Twitter and make themselves available. I appreciate your doing that.

You've talked about the difference between salaried employees able to save for their retirement versus an incorporated company. First of all, most small business owners I know say that their business is their pension. Most small businesses—and I'm sure Mr. Kelly could say this—fail within the first five years, probably 95% plus of them. Would you say that's probably true, Mr. Milligan?

Mr. Kevin Milligan: That number sounds reasonable. Again, I have to defer to Mr. Kelly.

Mr. Dan Albas: Okay.

Also, when someone signs up as a salaried employee, they usually agree to a certain salary, and they can actually plan to set aside money using the tax system.

I know that from the perspective of a small business owner.... It could be that something goes wrong with their equipment and suddenly what money they thought would go towards saving for something, such as their retirement, isn't there. In fact, again, after 10 years, I think that even then we still have close to 80% or so of small businesses failing.

Do you see how difficult it is for someone who works every day in their small business and is trying to make it when they see you put that out? Not wrongly, but again, in terms of saying $50,000 on this side when you're a salaried person versus when you do it in your business, you cannot say it's the same and look at how much more they have, because they are subject to so many more risks than a regular salaried employee. Do you see that there's a disconnect between the logic...?

Now, I agree from one perspective. The academic vision I understand, where you're saying it, but they are subject to completely different circumstances. Do you understand that?

Mr. Kevin Milligan: There certainly are different circumstances.

Mr. Dan Albas: Thank you.

I'd like to go over to Mr. Kelly in regard to angel investment. I spoke to a person who is retired and has a holding company. He spends the majority of his time finding small start-up tech companies where he can put his money.

He can put it into all sorts of different things, but he says, “Dan, if I don't have complete certainty...”. He gives some mentoring, but that may not be considered an active investment, so suddenly he's looking at putting money into Walmart and other publicly traded companies and then receiving a dividend where he knows 100% what his return is going to be.

Do you think this will have a negative effect on start-up capital for entrepreneurs?

Mr. Daniel Kelly: We do, and that's certainly one of the examples we brought forward to you on behalf of the coalition. Small businesses already start from a disadvantage when they are seeking financing. One of the reasons the small business corporate tax rate was created in the first place was to allow small firms to invest their own retained earnings back into their businesses, but the other benefit of this, of course, is that with respect to the passive income rule, the income that is saved in a business can be used to invest in other businesses, and that can be an incredibly powerful and valuable thing.

Governments have all sorts of supports, including labour-sponsored venture capital funds and other ways. The government is spending tons of time and money trying to find ways to support the business community. What businesses love is having other business owners invest in them, and the passive income rules can certainly help them do that.

● (1115)

The Chair: Thanks to all of you.

We will turn now to Mr. Grewal.

Mr. Raj Grewal (Brampton East, Lib.): Thank you, Mr. Chair.

Thank you to the witnesses for coming today. I really appreciate it.

To try to summarize a lot of your comments, there is a lot of passion and emotion about the proposed tax changes, and I really want to highlight the word “proposed” and put an emphasis on the ongoing consultation. I think we're missing something, which is that, in my humble opinion, this is how democracy in policy works best: something was proposed and now we're getting feedback from Canadians across this country on how we can change it.

Ron and Scott, thank you so much for comments on really making sure that there are no unintended consequences and that there are appropriate transitional rules. We don't want to put any businesses in a position where.... These things happen so quickly—and I do want to highlight the fact that the tax changes are going forward and are not retroactive—but you don't want any unintended consequences, because people do work really hard, especially on the family farm.

Mr. Milligan, I really appreciated your comment that it should be neutral in terms of your decision-making. Why should somebody benefit from a lower tax percentage when they incorporate for the sole benefit of having that lower tax threshold? Can you comment on that and why that's not fair for all Canadians?

I will give you an example. I used to be a corporate lawyer for a big firm on Bay Street, and partners were able to take advantage of incorporation, whereas a seven-, eight-, nine-, or ten-year associate was still a salaried employee.

Mr. Kevin Milligan: I would push back against the notion that we know that a certain number of people are incorporating solely for the tax benefit and bring it back to the previous member's question. When you are thinking about that decision to incorporate or not, there are definitely legal issues involved. There are a lot of business decisions involved. There are a lot of non-tax reasons for you to want to incorporate: to protect yourself legally or to encourage bank financing. There are a lot of good reasons to incorporate. There is no problem with incorporation. The issue is whether the tax system ought to be pushing people into incorporation or not.

When we're thinking about those tax benefits, what's important to think about here is that for some of the tax benefits that are on the table—I'm thinking of the income sprinkling as an example—this isn't something that pays you more because you have better ideas. It doesn't pay you more because you work harder or because you invest more in your company. It pays you more because you happen to have a certain family type.

If we want to have a tax system that encourages growth and investment, we can do a heck of a lot better than just handing out tax benefits to essentially random families. We can do better than that, and I think that's what we should aim for with the tax reforms.

Mr. Raj Grewal: Thank you.

Mr. Kelly, it feels as though you're part of the family these days because you come to the committee so much. We're happy to have you here again. Thank you for the deck on business fairness.

One of the things you spoke about was income sprinkling and the reasonableness test and the concerns around that, but would you not agree that there should be some contribution to the corporation in order to earn an income from it?

Mr. Daniel Kelly: Well, look, there are two things on that front. One, I think, is the challenge of determining for the CRA what is an appropriate contribution for the test that might be used, the reasonableness test. To be fair, there is a reasonableness test now that the CRA does implement.

Mr. Raj Grewal: In the Income Tax Act, yes.

Mr. Daniel Kelly: The challenge we have is twofold.

One is that the additional measures that the proposals are intending to bring we think are going to eliminate or reduce the amount of opportunities for younger people to get involved, even in a small way, in the family business. We do worry about that from a succession perspective, because you do want the entrepreneur to involve that next generation.

I was just in Winnipeg and met with a business owner who runs a successful trucking company. He said that he has had so many offers from private equity businesses to buy his business, but he knows the minute that he does that the jobs in Winnipeg and Manitoba are going to dry up, and they're going to be moved elsewhere. He's resisting that and wants to make sure that he can pass on that business to the next generation, so I do think that we don't want to discourage that kind of activity, and much of this does.

On the rules around income sprinkling, I also want to make the point that specifically with respect to dividends we want to make sure that government doesn't get to decide who owns the business. I understand what you're talking about with respect to income. That's why we already have the reasonableness test for income at the CRA, but applying this to dividends means that government is going to be able to determine essentially who owns the business. That is a concern for younger people. It's also a concern for us for female entrepreneurs. Two-thirds of business owners are owned by—

● (1120)

Mr. Raj Grewal: I'm sorry, Mr. Kelly, but I think you're—

The Chair: I'm sorry, Raj. You're already out of time.

Mr. Kmiec.

Go ahead, Tom.

Mr. Tom Kmiec (Calgary Shepard, CPC): Thank you, Mr. Chair.

Thanks to all of you for coming in and providing us your expert testimony.

I want to talk about retroactivity. Some of it is related to succession planning, so I'm glad that we were leaning in that direction. There's a lot of misinformation about it. Some of it is due to the government side. Minister Morneau has said these will not be retroactive, but the way I read proposed section 246.1 on CDAs, it will become retroactive. In fact, even well-known tax specialists and tax accountants have been writing and saying that if you inherit a family business you could pay tax on it, on gains that your predecessor made. Retroactive double taxation is the effect of some of the rules and proposals that have been made.

I see Mr. Kelly already pointing to Mr. Wonfor, who wants to comment on this, but I want to talk about this retroactivity and about the double and sometimes triple taxation on income already earned. If you want to talk about neutrality, it's patently unfair to double-tax someone as that's making its way intergenerationally.

Maybe we'll start with Mr. Wonfor, but I'd like to hear from Mr. Lanthier on that as well.

Mr. John Wonfor: I'm happy to speak for a minute.

With respect to the surplus stripping changes that are proposed by the government, there definitely is retroactivity built into those rules. The Department of Finance is receiving a lot of representations on that.

They say that the changes in section 84.1 only apply to dispositions on or after July 18, but that's not true, because you have to look back at all the transactions in determining whether you have a section 84.1 problem. You have to go back and look at all the transactions all the way back to when it was first enacted, I believe in 1984, and that can create some situations where you thought you had proceeds that you could extract because capital gains had already been paid, but now you're going to be forced to pay tax at a dividend rate if you extract those funds out of a company.

It's the same thing with the changes in proposed section 246.1. It talks about the amounts “received” or “receivable on or after [the] Announcement Date”. If you have a transaction that triggered tax beforehand, that triggered a capital gain before the announcement date, but you did not receive the funds until on or after the announcement date, there are problems with the planning right now. We don't believe it's fair. We respect the government's right to change their tax policy in respect to this area, but it should be going forward, not being retroactive—

Mr. Tom Kmiec: Mr. Wonfor, I'm sorry to interrupt you, but basically what Minister Morneau said when he said it was not retroactive, that's false?

Mr. John Wonfor: For capital gains stripping, yes, absolutely, we don't agree with that.

Mr. Tom Kmiec: Okay.

The Chair: Mr. Lanthier.

Mr. Allan Lanthier: In fact, I have just a brief technical correction. On the changes to section 84.1 and their impact on intergenerational transfers, the coming into force of the draft legislation specifically says that they apply to any dispositions, whether before or after July 18. The law is that the new rules apply to any disposition whether before or after July 18, so they're absolutely retroactive.

For someone who maybe passed away a year ago and whose advisers had post-mortem planning in effect to avoid the double or triple taxation, I can't think.... I was going to say that they're murdered by these proposals, which is a bad turn of phrase in the context of post-mortem planning, but yes, they can face tax rates of up to 90% and 92%. Those are the proposals with respect to section 84.1 that the government has put out for consultation.

The Chair: You have a minute, Tom.

Mr. Tom Kmiec: Just on the CRA, one of the things we hear from people who are proponents of some of these changes is that there's a reasonableness test now and there will be a sign. I have slide deck presentations from different tax accountants who've said basically it's going to ask the CRA to make a judgment call on whether a person's passive income, whether that's the TOSI rules or income sprinkling, is reasonable or not.

Based on my experience of the CRA for the past two years as an elected official, there's a complete lack of accountability for mistakes made by the CRA. I'd like to hear both from Scott and from Ron on the farm side about the impact of the compliance portion with the CRA, but I also would like to hear from the coalition against these tax changes, because what the government is basically going to be doing is giving a whole bunch of latitude to an agency and organization with a track record of making mistakes and crippling businesses.

● (1125)

The Chair: Ron, do you want to start?

Mr. Ron Bonnett: I think one of the concerns we have is that even if you do have a definition of the reasonableness test, that is subject to interpretation, and when you get to CRA officials, individual CRA people may make different adjustments. I had the same thing happen on an HST case. I had to take it to two or three people before it was resolved.

I think being very specific and very clear, as well as having training for CRA officials to interpret what is meant.... This creates a lot of concern for the farm community, I think, because we don't know how it's going to be judged until we file those returns.

The Chair: Mr. Kelly, do you have anything to add on that, very quickly? Or Mr. Wonfor?

Mr. John Wonfor: I'll make one quick comment with respect to that question. Absolutely, the professional community and the business community are concerned with the reasonableness test. The Department of Finance has set out a few principles, but is now basically I think going to leave it up to the CRA to administer it.

I know from talking to certain senior CRA officials that they're not very happy with that, because they don't know how to administer a reasonableness test. I agree with you that there have been challenges in the past, and there will be challenges going forward with respect to this. You can expect a lot of tax litigation.

The Chair: Thank you.

The last questioner for this panel is Mr. Sorbara.

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

Thank you to everyone who's come here today and has provided some good stuff to think about.

I've sat down with a number of tax experts over the last couple of weeks. I spent half of my Labour Day going over all the proposals in the consultation paper. I understand that tax fairness is important and how we need to get it right. I think the spirit of tax fairness and the road we're on the right path.

We need to ensure our tax system has the right incentives in place to encourage capital formation and to encourage small businesses to grow, not to just stay at the 15% level but to move up to the 26% level on taxation, which is a good thing, because it shows that businesses are succeeding. We also need to ensure that we have the right proposals in place.

I've looked at this consultation paper as being in two buckets in terms of—I think someone alluded to this—the professionals and what I would deem as the small businesses like your manufacture and your engineering firm. We don't want to impede the second bucket from doing what they're doing. They're doing things very well in Canada. We have a growth rate of 3.2% this year, the best in the G7. We've created hundreds of thousands of jobs, and I attribute that to a lot of SMEs investing in their businesses and hiring Canadians.

In looking at the buckets, two of them, I think, do have merit. One is extending the income sprinkling not just to include income, because that's already covered, but to also include dividends, because if someone is working for an organization or farm, they can still work for them and they'll still be paid. Now, there's some clarification needed around “reasonableness” and “continuous” and words like that, and on the conversion of dividends to capital gains, and the multiplication of lifetime capital gains exemption. There are some things there that do have a lot of merit in the initial set.

On passive income, obviously a lot of questions need to be answered. I represent an area where we have 13,000 private businesses. York region is very dynamic. There's a lot of growth is going on, driven by private business. I know that we're consulting. I'm consulting. I speak to business owners every day. I know that our government's consulting. I encourage everyone to submit a brief by October 2.

Mr. Kelly, don't you agree there is merit in those first two measures, on examining them in the spirit of tax fairness, which we really need to do?

Mr. Daniel Kelly: We've said right from the beginning that we are on board to work with government on any necessary tightening of tax rules to ensure that there aren't abuses by business owners. I do wish to defend, though, the so-called income sprinkling.

One of the things that is very difficult for government to determine —and you know this from your riding, from the business owners you're talking to—is that there is a formal role, with a desk at a job and a specific title that a person might have, but there are also a lot of informal roles that business owners play, either as a shareholder or as somebody who does work in the business.

The reason we call them mom-and-pop shops is that mom and pop both have a stake in the business, and what these changes are proposed is making some pretty radical changes to that. At a minimum, it's going to create about a decade of uncertainty for business owners at a time when I just don't feel we can afford it.

● (1130)

Mr. Francesco Sorbara: I heard this yesterday from one of our presenters. Thank you to everyone, because I appreciate it when people avoid using the rhetoric versus what is really the meat of the issue. Again, we need to look at tax fairness. We need to look at tax fairness for all Canadians.

We've done this on tax avoidance. As a government, we've put in hundreds of millions of dollars to ensure that all Canadians are paying their fair share of taxes, to ensure those services that Canadians depend on day in, day out are available to Canadians, and that people have confidence in our tax system. We've done that. I applaud our government for doing that. I'm proud to be part of a government that's doing that.

On the tax fairness side, again, there are measures there that we need to look at, such as, for example, extending on income sprinkling, because if your son or daughter is still involved in the business.... Again, what are we talking about? We're talking about moving the age limit from 18 to 24, where arguably you could see that the uptake is in reference to a lot of parents paying their kids—and paying them in a tax-advantaged way—to go to university. Going to university is a great thing, but a lot of businesses are using that loophole or tax advantage situation to fund someone's endeavour whereas other folks can't fund that endeavour on that basis. I think there's a real chance for us to do this right, to consult with businesses.

Look, in B.C., 25 years ago, I was awarded an entrepreneur of the year award by Grace McCarthy. I love entrepreneurs, but—

The Chair: Do you have any thoughts on that question? We do have to go to the next panel.

Ron.

Mr. Ron Bonnett: I have a quick comment. I hear the word “loopholes” a lot, but it's really using tax-planning tools. One of the things that gets lost in this discussion is the fact that businesses and farmers need certainty in their business and tax planning. I think that's one of the things that has really brought a lot of people to the forefront. I've had farmers come to me and say, “Look, we've spent $40,000 over the last two years setting up our organization so it transfers to the next generation, and now we don't know if we're going to have to go and spend another $20,000 to do it the same.”

That's why we need long-term policy in place. Business has to be engaged in that discussion so at least there's certainty for planning in moving ahead.

The Chair: Mr. Lanthier.

Mr. Allan Lanthier: I believe income splitting and income sprinkling are tax policy issues. There are some very aggressive plans in place with so-called alphabet shares—A, B, C, and D—and one pays dividends to whoever one wants. Whatever is going to secure the best tax result, you pay pay on the A, B, C, or D shares. I think there's a policy issue. The taxation unit in Canada is the individual, not the family unit, but thus far, the government has gone about this in a very ham-handed way.

My personal suggestion for addressing this and addressing 80% of the problem is to extend the existing kiddie tax with no reasonability test to all children up to age 24, and with respect to multiplication of the lifetime capital gains exemption, allow one lifetime capital gains exemption per married couple or common-law partners. I think that's simple, understandable, and addresses 80% of the government's revenue concerns.

I'm opposed to income sprinkling. It's poor tax policy to allow it. I just think there's a much smarter and more sensible way to go about it.

The Chair: Thank you.

I do have one quick question. I'm hearing from some people that we should extend the consultations and from others that we should end the consultations, but I guess in terms of certainty in the economy. We as a committee are holding hearings pre-budget 2018 on competitiveness and productivity.

In terms of overall certainty in the economy—so that there isn't a flight of capital and people aren't making decisions based on the rhetoric that's out there—how important is it that the government bring clarity to this issue and does it quickly? Who wants to answer? This is probably more related to the tax people who are in the system.

Dennis.

● (1135)

Mr. Dennis Howlett: We certainly support the call for more extensive public consultations on the whole fairness of the tax system, but we would not support the government's not going ahead with the current proposals, because we do think they are a step in the right direction. That being said, we would support the call for a more comprehensive review.

The Chair: Mr. Lanthier, you'll have the last comment.

Mr. Allan Lanthier: There is significant uncertainty. I get private emails every week saying, “I'm pulling my money out of the country.” These were not *National Post* or *Globe and Mail* op-eds. These are private emails in which people are silently saying that they can't put up with the uncertainty.

I don't agree with what was said before about having almost a royal commission on taxation. We don't need a royal commission on taxation. We can address the policy issues that have been tabled here —on all three fronts, I think—with simple and sensible approaches. They're not the approaches that have been set out by the government.

I do think we need an independent review, but there has been discussion here, Mr. Chair, about involving what I'll call the business lobbyist group and this group and that group. We need the Minister of Finance to establish a committee, set out clear terms of reference, and have that committee meet with no political influence—no Department of Finance influence or Revenue Canada influence— like the Mintz committee, on which I was proud to serve in the late 1990s, free from political or Department of Finance influence. The Department of Finance folks—and I have many friends there—will not like it, but that's the only way to get a dispassionate discussion.

Thank you.

The Chair: I want to thank each and every witness, and members as well, for keeping relatively on target on the issue. It is an important issue, and we covered its breadth. I think it was a really good discussion on the points that are in the discussion paper.

Thanks to all of you. We will suspend for about three minutes while the next panel comes up.

● (1135)

(Pause)

● (1145)

The Chair: We'll call the meeting to order. Just for the record, pursuant to Standing Order 108(2), we're doing a study of tax planning using private corporations.

Witnesses, just so you're aware, the minutes from this committee and any paperwork, etc., that you give us will be passed on to the minister's office as part of the consultations on document that is out there on tax planning using private corporations. That information will go, without recommendations from this committee, to the minister. With that, we will start.

Welcome to all of you. Thank you for putting your thoughts together on quite short notice, in many cases. We really do appreciate you appearing today.

We'll start with Mr. Weissman, who is a chartered professional accountant.

Welcome. The floor is yours.

Mr. Peter Weissman (Chartered Professional Accountant, Trust and Estate Practitioner, As an Individual): Thank you for inviting me to this session. I really appreciate the opportunity to express not just my views but the views of many tax people out there.

Earlier, I was in the gallery listening. I just kept shaking my head and saying, “Wow.” Why are we here? Is this really necessary?

It will be—I hate to say it—30 years next month that I have practised in tax, and I've never seen such outrage and anxiety, not just in the business community but in the tax community as well, about items that in my opinion are quite simple to address, and you'll hear why.

We have proposals that were released in the middle of July with a 75-day consultation period. The website says submissions are due no later than midnight on Friday, September 29, but we've been told submissions are due October 2. Yesterday at the Canada Tax Foundation conference there was some inconsistency. Maybe we could get some clarity. I don't have a submission for you today because of short notice, but I would like to give you one.

I think we all need to take a step back. It's important because, in my opinion, you can't pick solutions without knowing what the problems are, and no one can see the forest for the trees in this case.

I do think that the government's policies and objectives in terms of income splitting with respect to corporate deferral are valid policy objectives. I think they're in line with the election platform that they ran on. I think they are achievable objectives in a much simpler manner than is proposed now. I'll give you some suggestions. I'll throw a lifeline out there and say that if you want to end this, if we want to salvage what's going on now and actually move ahead with objectives in the economy and reduce uncertainty for businesses, here are some ideas.

Again, I think the policy intent is fundamentally sound and in line with the election platform. However, I think the proposals—not “I think”, but “I know”—go way beyond that. I'm speaking to you as someone who has been in the trenches for 30 years dealing with tax legislation and tax changes. I started in tax when tax reform came around in 1987. I've seen the capital gains exemption eliminated on capital gains on property. I've seen it restricted. I've seen the kiddie tax brought in to deal with income splitting and income sprinkling—a term that has now been coined—so I have ideas.

Before I forget to get this out there, there are no ifs, ands, or buts: these rules, most of them, are absolutely retroactive. It's not true to tell the Canadian people that these rules are just for going forward. As we heard earlier, tax attributes of the shares that you own in your family business that were created 10 years ago because of transactions last year or 20 years ago impact the calculation of the tax that will be calculated under these rules. While they may say it's for transactions after July 18, these rules are retroactive, because there's no grandfathering and there's no transition.

It's like telling someone that they have their house and they've accumulated all that growth tax free, but we're changing the rules. Their house is going to be taxable, but on the go-forward, only if they sell it from then on. If they sold it before this was announced, okay, they're fine. That's retroactive tax planning, and that's what some of these rules do to businesses.

What I'd like to say in the brief time I have is that I think income splitting is a valid policy target. I know that reasonability is not the way to go. Uncertainty and subjectivity in the tax code is a recipe for litigation and for costs, and for unhappy taxpayers who don't have the funds to litigate. As much as possible, you have to take judgment out of the Income Tax Act. We need objectivity.

The reasonability test on dividends just can't be determined. Reasonability on salary is hard enough, but at least there are ways to do a functional analysis. You can't do that with dividends.

I've heard one example of extending the kiddie tax to age 24 as maybe a compromise of how to deal with curtailing income splitting. How about figuring it out this way? If someone spends more than *x* number of hours per year in the business, the rules will apply or won't apply. This kind of rule is actually used in the disability tax credit area, an area that I was involved in many years ago in terms of advising. With respect to life-sustaining therapy, we couldn't define what that meant, so the rule was put in that if you spend more than 14 hours per week on life-sustaining therapy, you're eligible for the DTC. Something like that could be used, as opposed to a reasonability test.

● (1150)

When it comes to corporate deferral, I just shake my head. Why are we talking about passive income and taxing passive income? You're getting people up to 70% and penalizing people for earning passive income in a corporation. The reason is that there's this corporate deferral because my corporate rate is lower than my personal rate. This has been dealt with. I'm just shocked that we get these proposals about passive income.

We have personal service business rules in the act. A long time ago, athletes and entertainers would incorporate themselves. A hockey player who was working for a hockey team would incorporate and say to pay his company, because he was going to get corporate rates instead of employment rates. The government brought in the personal service business rules and said that if you don't employ more than five full-time employees, you don't get the small business rate. They got rid of the small business deduction for incorporated athletes.

More recently, it was used for computer programmers and other professionals who incorporated to get access to the corporate rates. Computer programmers fall under the personal service business regime if they are incorporated, and there is now a surtax on personal service businesses. That surtax brings up the corporate rate without increasing corporate rates on everyone, which I don't think is what the government wants to do. The surtax increases the effective rate, reduces the deferral, and can be targeted at the people I think the government is really trying to target. I'm one of them. I'm throwing myself on my sword here.

If you want to stop people like me from incorporating just to get the benefits of the low corporate rate, stop me from doing it. Tell me that if I incorporate I'm going to have a surtax, but don't tell me that you need to affect all the family businesses across Canada.

These proposals could stop there because I think those are the government's policy objectives, but they go way beyond. The anti-surplus stripping rules in proposed section 246.1, which we won't get into, are so ripe with ambiguity and uncertainty that they are impossible to plan for.

Finally, because I imagine I'm running out of time—

The Chair: Go ahead.

Mr. Peter Weissman: —these rules as proposed will make a family decide to sell their business to an outsider instead of passing it on to the next generation. There are no ifs, ands, or buts about that either. These rules say that if you sell to a family member, you're going to be taxed at dividend rates of 45%, but if you sell to an outsider.... That's obviously not right.

The last thing is, who you are going to sell to? Private businesses are not going to be interested in buying new private businesses or existing private businesses, because they're going to be looking to get out of the private business world with these rules. Who's going to buy? Public companies and foreign corporations are going to be buying up Canadian family businesses if these proposals go ahead as proposed.

My last comment is that I really think a collaborative effort would go a long way to resolving these issues, because there are people like me in the profession who are level-headed, understand the policy objectives, and have experience. If we sat down in a room with Finance and whoever the right people are—the economists—I think we could hammer out proposals that would be acceptable to everyone in this room and, more importantly, to Canadians.

● (1155)

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

I'd like to clear up what I think is the confusion on the dates. The end of consultations with the Department of Finance is Monday, October 2. They don't have midnight on it, but usually it is midnight. Our deadline for submissions to this committee, the finance committee, is September 29 at midnight, which is Friday, the reason being that we want to pass that information on to the Department of Finance on Monday morning or Monday during the day.

The firm deadline for Finance is October 2, which is Monday. We may have confused it a little with our separate deadline, but we had to do that in order to get the information there.

We're turning to Ms. Workun, who is appearing as an individual.

Welcome.

Ms. Denise Workun (As an Individual): Thank you.

I also very much appreciate the opportunity to appear before you today and share my thoughts. I'm someone who was raised in Alberta, and I have lived in Quebec for 25 years. I'm a lawyer who has practised human rights and employment law in Ontario for close to 30 years now. I'll make it very clear: I don't practise tax law, so I am by no means a tax expert, unlike my colleague here to my right. I also want to make it clear that these are my personal views.

I was prompted to engage myself in this tax debate on a more public level, in response to an email that I received from the president of the Canadian Bar Association a couple of weeks ago—three weeks ago, perhaps—basically encouraging members of the CBA such as me to write to their MPs in opposition to these tax reforms, and also informing us as members that the CBA was going to take a public position in opposition to these tax reforms. That got my attention, and I immediately responded to the CBA president, as well as copying my MP, to ensure that it was known that the CBA does not speak for me. I'm a lawyer, and I very much support the tax reforms that are currently being proposed.

I think it's important to speak up, and so that's what I've done. I'm joined in that by a number of physicians as well, many of whom are young female doctors who, I'm sure you are aware, have published a very public and articulate letter that similarly supports the tax reforms being proposed, and also states publicly that they are not in agreement with the position being taken by their professional representative in that situation, the CMA. The author of that letter—I heard her being interviewed on *The Current* a couple of weeks ago—is a very articulate young woman who is currently on maternity leave.

My starting premise is that it's a good thing to build a society in Canada where we all have access to a solid education, health care, housing, safe and vibrant communities, recreation and sports opportunities, and a clean environment. Perhaps it's misguided on my part to believe that the revenues generated by these tax reforms will funnel down toward the collective good, but certainly that's my hope.

The bottom line for me is that it obviously requires tax revenues to sustain and improve the public institutions and social programs that Canadians, I think in general, support. My view is that the most effective and just means to generate those revenues is through a fair, transparent, and actually progressive tax system. To me it doesn't make sense that those individuals most financially and otherwise privileged in Canadian society—including me—who've had access to publicly subsidized post-secondary education, are further advantaged by the tax system.

I do, however, think that tax reform should be comprehensive, and in that regard I think we need to start with the private corporations, as the government is currently doing, but I also think we need to revisit those other aspects of the tax system that are similarly regressive, for example, income splitting of pensions. There has been some criticism, I think justifiable criticism, by small businesses saying that, look, recipients of federal government pensions, for example, are entitled to split those pension incomes. I agree. That's not consistent in terms of giving, effectively, an income splitting benefit to pension recipients.

Turning to RRSPs, why should it be that the more money I make, the greater access I have to RRSP contributions? It's up to a maximum cap, I appreciate, but it is fundamentally based on a percentage of income up to a cap.

Why should it be that someone like me, who can most afford to send my kids to university and pay for them, has access to government grants through an RESP system, whereas others earning family incomes of $49,000, the average in Canada, are barely able to pay their mortgages or rent, let alone put monies into an RESP to help fund their kids' education with the support of government grants? The tuition rates are going up because we're lacking public resources to adequately fund those public post-secondary institutions.

● (1200)

The last couple of comments I'd make relate to gender. I've heard a lot of spin around the subject of gender and that these tax reforms are somehow damaging to women. I don't buy that for a moment.

I don't have the data to prove it, but I think somewhere the government could improve upon coming up with data that answers the question of whether this tax reform is going to disproportionately adversely impact women. My intuitive sense is that women, single mothers in particular, who I believe are disproportionately represented in terms of the poverty figures in this country, will be the beneficiaries of added tax revenue, assuming, of course, that those revenues are used to fund social programs and public institutions on which these women and their children rely.

Finally, in response to a comment that was made earlier that I heard in the gallery about the risk that small business people are taking, I appreciate that risk, the theory being that you need to save within a corporation and your business so you can fund the years that are not so great. As a lawyer who works daily with employees who have been laid off from their jobs, many of whom don't have pensions or benefits once their employment is terminated, I can say that those individuals are left with having to rely on their personal savings, just like everybody else, to fund them through difficult times. They also work very hard for the money they save.

As I say, I feel there should be a more level and equitable treatment of all working people in Canada. Thank you.

The Chair: Thank you very much, Denise.

We will turn to Terry Soloman, who is partner of tax services with the MRSB group.

Welcome, Terry. The floor is yours.

Mr. Terry Soloman (Partner, Tax Services, MRSB Group): Good morning, Mr. Chair and committee members. Thank you for the opportunity to speak here today.

My name is Terry Soloman and I have practised public accounting in Charlottetown, P.E.I., for the past 27 years.

I can say without a doubt that these proposals are very damaging to the small business clients I represent, as well as to small business across Canada. I don't think it's an overstatement to say that these are the most significant tax changes that have been put forward since the royal commission in the early 1970s. I really feel that changes of this magnitude need to be done with genuine stakeholder engagement.

The proposals, as well, were accompanied by rhetoric such as “closing loopholes” and “using corporate structures to avoid paying their share of tax”. Frankly, members of the business community find this type of communication offensive and are made to feel as though they're being some sort of tax cheats even though they are complying with the laws of the land. I believe the business sector needs to be encouraged, because when they have success, it creates jobs in their community.

I am going to talk about a few specific concerns I have with the proposals in the time I have this morning.

First of all, my main concern is that the proposals actually miss their stated target of targeting the wealthier sector of society. I believe there will be a flight of capital from Canada. I believe these changes will impact recruitment and retention of skilled labour such as physicians and others.

The proposals with respect to income splitting will actually disproportionately impact the middle class more than the upper class. These proposals devalue the real contribution a spouse makes to a family business, whether that contribution is direct or indirect, whether they're actually going to the business every day, or whether they're supporting the other spouse in order for the business to maximize its profit and the amount of tax it will generate for governments.

I have already provided my written submission to Finance. In it I note that even a family with $70,000 in annual income could be faced with a 30% to 40% tax increase if these proposals go through. We're not talking about the high-end income; we're really talking very much about your neighbours, small business owners in Canada.

The discussion paper that was issued by the department compares a business person with an employee and how much income tax each of them would pay. It contains an overly simplistic analysis. There are many factors to consider other than the pure upfront tax calculation.

My second concern is with the significant uncertainly around the new reasonableness test. This test will give the Canada Revenue Agency the power to unilaterally determine the value of certain adults' contribution to a business. This test will be very subjective and fact-based. This is a significant new burden on small businesses, which are not even going to have tracked the information that would be needed to defend themselves. It will be the subject, I am quite confident, of much new litigation and disagreement.

Just as one example, is a wage that's paid in Prince Edward Island for a service different from a wage paid in Ontario? How is CRA—and I almost feel bad for them—going to actually administer this test in reality?

● (1205)

I would say that in my view, the most egregious proposal relates to the taxation of passive income. Passive corporate income is already taxed between 50% and 55% in Canada. It depends on the province. In fact, it's taxed at a higher rate than most personal rates. Without question, there is a tax deferral on the initial capital that the passive income may have generated, if that capital came from a small business deduction. However, that is not a loophole. That was something that government intended to give small business access to capital for either future expansion or for working capital during slower periods. These proposals will eliminate the long-standing concept of tax integration in Canada, at least on the payment of some dividends. The effect of this for a P.E.I. corporation is a passive tax rate that could reach 74.55% and would have a similar result in other provinces.

This is clearly unacceptable and I'm hopeful the government would not have intended this tax result.

Holding companies are also used as a vehicle to accumulate funds for retirement, in lieu of an RRSP. Funds accumulated are similar, in some ways, to an employee who has a registered pension. However, employee and employer contributions to a pension and the income realized bear no tax whatsoever until withdrawn, which could be many decades later. Conversely, the business owner who uses a holding company for investment has already paid a tax of between 15% and 30% on the initial capital and an annual tax of 50% on the earnings that are realized.

For all these reasons, I would strongly recommend that the proposed changes for passive investment be abandoned entirely.

A fourth concern I have relates to some of the proposed changes to section 84.1. While I do agree that some changes here are required to address certain planning that was happening, the proposed changes, as currently worded, lead to double, and even triple, taxation and will negatively impact estates and common post-mortem techniques, some of which were already in progress at the time of the announcement.

Government has recognized that section 84.1 does impede succession planning for family business and, as part of this consultation process, I encourage them to also deal with that and not just have that in the discussion paper and not actually deal with it.

● (1210)

The Chair: Terry, could you sum up fairly quickly.

Mr. Terry Soloman: Sure.

I also wanted to address, as I believe it's been mentioned already, that these proposals do have retroactive application. Taxpayers are entitled to structure their business affairs with certainty. Many of these structures have been in place for many years with the full blessing of the Canada Revenue Agency and the courts. I don't believe that it is fair to fundamentally change the system. People should have no doubt that it is being fundamentally changed here.

For the reasons outlined above, I believe the proposals, as presented, are deeply flawed and should be set aside. However, I do support a review of the current corporate tax system in Canada with a view to modernization of the system. This would best be done through a royal commission on tax reform with a mandate to look at all of the issues that are being raised through this consultation process and come up with a reasonable compromise.

Thank you.

The Chair: Thank you, Terry.

We'll be turning to Ms. Dutt, a family physician, who is speaking as an individual. Welcome.

Dr. Monika Dutt (Family Physician, As an Individual): Thank you.

I've been up since three o'clock. I took the flight out of Cape Breton this morning, one which Ms. Raitt might have taken in the past, so it's been a long morning so far.

I could just say ditto to what Denise said, but I will read what I have here.

I am a family physician from Cape Breton, Nova Scotia. I am the daughter of a small business owner. I am here to speak to the content of a letter that was signed by close to 500 physicians and medical students across the country. The letter's signatories and I are in favour of the proposed federal tax changes for Canadian-controlled private corporations, or CCPCs. The reason we are in favour is that we support greater equity amongst Canadians.

Let me say first that this is not unequivocal support. It is regretful that the federal government has not closed the tax loophole of being able to be paid the stock options used by CEOs and other high-income Canadians. Given that Canada's top CEOs earn 193 times what the average worker earns, it is imperative that the government keep its election promise. As well, various other policies that can be implemented, as was mentioned particularly in the last session, should also be considered.

Cape Breton is a beautiful island with rolling hills and exquisite ocean views. That's the image you tend to see in tourist brochures. In contrast to those scenes, one third of our children on the island under age six live in poverty. There is a first nation just down the road from me, and they cannot drink, cook with, or bathe in their water. A patient I had in clinic yesterday holds three minimum wage jobs, barely sleeps, and is struggling to take care of her daughter as a single parent.

In contrast, the vast majority of physicians remain amongst the top 1% to 5% income earners in Canada. We as doctors recognize that adequate tax revenues are needed to fund such social programs as affordable housing, social assistance, legal aid, hopefully one day national pharmacare, and the health care system itself. These programs directly impact the health of our patients. We believe it is important for us to contribute to their sustainability through an adequate tax base. We do ask that any tax revenue that is gained through these tax changes go to funding policies and programs needed to ensure the health of our patients.

Now, physicians are in a unique situation of being publicly funded but mostly self-employed, often running practices with varying amounts of overhead. Many physicians do have legitimate concerns about their work situations, including a lack of extended health benefits, parental leave, or pensions. We have long training periods, incur significant student debt, enter the workforce late, and have high rates of burnout. However, we feel that these issues are best addressed at their root, with the best of all available policy solutions, and not in inherently unstable ways such as through our tax system, which is constantly evolving.

It is important to note, however, that the methods that have been primarily used by some doctors—lower tax rates on passive investment income through a corporation and income sprinkling—are legal, and were in fact encouraged by several provinces in lieu of fee increases as part of negotiations, despite federal jurisdiction over relevant tax policy. We know that these benefits are advantageous, as was pointed out earlier, primarily for certain incorporated doctors with specific family situations and those who earn enough to supersede traditional saving vehicles available to all Canadians. This seems unfair to single parent physicians, of whom I am one, and those with young children or those who are unincorporated. It also seems unfair that these benefits are not available to Canadians with similar incomes who cannot incorporate. It is also worth remembering that only 60% of physicians are incorporated, and this option has only been available in some places in the past decade or so.

That said, the changes we are supporting cannot be made without a transition plan, nor in isolation, but rather as part of a comprehensive review of tax policy with a view to equity. As such, we call on the federal government to do four things.

One, implement proposed reforms to CCPCs as a first step in a comprehensive reassessment of tax policy in Canada, especially mechanisms that disproportionately benefit large corporations and the wealthiest Canadians.

Two, outline a clear transition plan for savings held in medical professional corporations. Physicians who have used these methods under existing agreements to prepare for retirement should not be unfairly penalized.

Three, work with the provinces and territories to review options for access to extended health benefits, parental leave, and pension plans for all Canadians, as well as payment reform options that would be available to all physicians and address these important aspects.

Four, work with provinces and territories to tackle the issue of increasing medical student debt, namely, by lowering tuition for incoming students and implementing forgiveness programs for existing debt.

● (1215)

I realize that the federal tax changes go far beyond the concerns of physicians, but this is the world that I know, so it's the one I'm speaking to. What I feel and what many physicians across the country feel is that an equitable tax system is a goal that we can support and can pay into.

Thank you.

The Chair: Thank you, Ms. Dutt.

We turn to Mr. Paquet, appearing as an individual.

[*Translation*]

Dr. Alain Paquet (Full Professor, School of Management, Economics Department, Université du Québec à Montréal, As an Individual): Thank you very much Mr. Chair.

I also thank the members of the committee for giving me the opportunity to speak with them and the other witnesses on this important review of tax planning through the use of private corporations.

I am an economist and professor of economics at the Université du Québec in Montreal. I have worked at the university since 1988, with the exception of a nine-year period during which my class was bigger and less disciplined, and I was the one taking the exams; I was a member of the National Assembly. I occupied different positions there, but whatever position I was in, I acted as the premier's senior economic advisor, and was one of the senior drafters who contributed to preparing the government's economic program between 2003 and 2012. I also had the opportunity of being the chair of the Public Finance Committee for seven years. And so this to me is like a homecoming, but on the other side of the table and in another of the country's parliaments. For a few years I was also minister delegate for Finances, the equivalent of the Minister of State for Finance at the federal level.

And so I was often privy to matters related to the budget. I knew both the theoretical and empirical aspects as a professor and researcher, and the practical aspect, since I dealt with budget preparation and the issues the various persons concerned had to debate. Ultimately, when we talk about taxation, we are talking about its impact on the economy and on the people who participate in the creation of wealth and the distribution of that wealth.

In that context my preliminary remarks will bear on a certain number of principles. I will probably have the opportunity to talk about them more in detail in the subsequent discussion.

The last broad tax reform in Canada goes back to 1971, following the 1966 Carter report. In many regards our current fiscal system is based on that. There have been a few ad hoc important changes made. Among others, the very good economic reform of putting in place the GST, and the improvements that followed.

Other elements were introduced following the report tabled by Jack Mintz in 1997. This allowed businesses to benefit from a tax reduction, which was necessary at the time, in addition to improving the neutrality of the taxation system, a principle I will get back to.

However, the economy has changed in the meantime. For instance, the service sector is increasingly important within our economy. This does not mean that we should sacrifice other aspects of the economy; however, we have to take economic reality into account as a whole, and ensure that taxation really attains its goals. These goals are established and analyzed in particular from the perspective of fairness and efficiency. These two principles are the subject of a public debate that is sometimes very rapid, unfortunately. The newspapers have a tendency to systematically present those elements as being opposed to each other, but that is not always necessarily so.

In the context of the elements of reform and the principles behind them that are being put forward by the Department of Finance, the Minister of Finance, and the government, it is clear that in some regards, one of the elements identified does pose a fairness or non-neutrality problem. In fact, we may encourage businesses or entrepreneurs to incorporate in order to benefit from the tax system in a legal way, insofar as the current laws and regulations apply. However, we have to pay the costs, deploy resources and find ways of reducing taxes, not only to improve the growth of businesses but also for fiscal reasons, quite simply.

In my opinion, you should not do indirectly what could better be done in a direct manner. As to whether taxation is too high or too low, that can be debated. There are in fact several debates on that topic, and several positions, and I would be happy to contribute to that debate myself. One thing is certain, we have to make sure that taxation does not become excessive. To meet that objective, we encourage very careful planning. This is done in particular through income distribution by incorporation. People resort to this not to become entrepreneurs but for taxation purposes. Passive investment portfolios can also be used, but these do not allow the corporation to grow and to prepare for the future. In my opinion, certain elements could be improved in various ways. We could encourage income distribution through capital gains in order reduce taxation.

Neutrality means ensuring that comparable situations are treated in the same way. We should aim to improve that neutrality, which is in my opinion an important principle. In principle, the proposals which have been made are a step in the right direction.

● (1220)

That said, we have to avoid what may appear to be exceptions—the point is not to provide for all possible scenarios—where the same income might be imposed in different ways, as well as cases where there would be retroactive taxation. Such situations need to be avoided, both in economic theory and economic practice.

There are also issues related to transferring businesses. That is one concern that was submitted to me. Some work needs to be done in that regard, and we will have an opportunity to discuss it further. When I was with the Quebec government, I examined that issue. There were epic debates with government taxation experts. These were not partisan debates, but the taxation people wanted to avoid creating precedents when some problems could be solved.

Comprehensive tax reform that would take all of the principles into account would be desirable. That does not mean, however, that there aren't specific aspects that could be better calibrated to eliminate the unfairness that exists in the current system.

In conclusion, may I repeat that the point is not to jeopardize the tax competitiveness of Canadian businesses. That being said, there is certainly cause for concern regarding what is looming, that is to say the measures the American Congress will be taking in the next weeks or months, whatever form they take.

We must certainly maintain the principle of tax competitiveness, but we have to do it the right way. That does not mean that we should allow unfairness in taxation, as we see now in certain cases.

In conclusion, I'd like to refer you to a few words from a recent article entitled “Les enjeux d'efficience et la fiscalité”—efficiency and taxation issues—which I penned with a colleague. Without aiming for perfection, and while taking into account imponderables and democratic requirements, with leadership and education, we can do better.

Today's hearings and the work that must be done should not be rushed, but this process should not lead to inaction either.

● (1225)

[*English*]

The Chair: Thank you very much to all the witnesses.

In order to get eight people on, we'll have to hold people to about four minutes each. Please keep your questions short and snappy, and your responses also.

We'll start with Mr. Fergus.

[*Translation*]

Mr. Greg Fergus: Firstly, I would like to thank all of the witnesses who are here.

My first question is addressed to all of the witnesses, and I would like them to answer in 10 seconds, if possible.

Does the current system provide advantages to the owners of Canadian private businesses that are not offered to salaried workers and the owners of non-incorporated small businesses?

Dr. Alain Paquet: Unfortunately, that is sometimes the case. There are reasons why corporate and personal taxation must be different. Businesses aren't up in the air somewhere, they belong to individuals who can be taxed. So there must be differences.

That said, when the system encourages people to incorporate for taxation purposes and not for entrepreneurial purposes, the objective that was sought is not being attained.

[*English*]

Mr. Greg Fergus: Dr. Dutt.

Dr. Monika Dutt: I'd say yes. As I mentioned, within physician structures there is inequity between those incorporated and those not. For various reasons, about 40% of physicians are not incorporated. That compares with the vast majority of Canadians, who are not incorporated.

Mr. Greg Fergus: Thank you, Dr. Dutt.

Mr. Soloman.

Mr. Terry Soloman: To that I would say that there are many reasons to incorporate a business. The lower tax rate, in order to be able to fund expansion and working capital, is clearly one of the reasons and incentives that past governments encouraged and wanted.

I don't want to call it a loophole. I want to call it an incentive.

Ms. Denise Workun: My understanding and perspective is that private individuals who are able to privately incorporate enjoy a significant financial advantage over those earning comparable incomes who are not similarly able to incorporate.

Mr. Peter Weissman: I'm sorry, I want to clarify the question.

Was it just in general? Are there corporate benefits to tax savings from incorporating?

Mr. Greg Fergus: I just want to know whether there are some inherent advantages in the system as it exists today for those who are incorporated as distinct from those who are not, who include, of course, salaried persons.

Mr. Peter Weissman: Yes, there are.

Mr. Greg Fergus: Thank you very much to all of you for responding to that question.

My other question, which may give you a little bit longer to talk about it—and some of you already started to do so—is whether that is fair.

[*Translation*]

Mr. Paquet, you have the floor.

Dr. Alain Paquet: As mentioned earlier, there is unfairness when similar situations are treated differently by the taxation system. The issues put forward by the government in this regard are relevant.

Once again the point is not to jeopardize the competitiveness of companies, nor to prevent them from investing in subsequent development when it is very important that they do so. There are certainly concerns around exceptions that must be looked at. Fairness is an important element, but it should not be seen as inimical to efficiency, because we want to encourage Canadians to create businesses that will grow and make our economy even more dynamic.

[*English*]

Dr. Monika Dutt: I'd like to say it's not incorporation that is the problem we've talked about. There are various reasons why someone might incorporate. I would just say that from the perspective that I'm speaking from as physicians who are higher income earners and often use benefits from a corporation to defer taxes, to pay less taxes, to have a higher income.... That's the angle I've been coming from, it's not incorporation necessarily that's the problem; it's using methods to decrease your tax burden when you are already quite a high-income earner.

● (1230)

Mr. Terry Soloman: I would say in any tax system there are going to be some who are taking advantage of certain things and that maybe was not intended, but I believe for the most part the current system is working. As I mentioned before, I do think that's really why a comprehensive review of the system to deal with any of those types of inequities would be appropriate.

Ms. Denise Workun: My view is that I obviously don't think it's fair, and not only that, I'm not convinced that the current tax regime is delivering value to the economy. For example, if the policy intent is to retain earnings in a corporation so as to expand that active business, something like passive investment does not achieve that policy objective. It's merely a mechanism to shelter from tax or defer tax on income going to that individual who's incorporated as opposed to using that money to expand the active business and thereby, arguably, benefit the economy.

The Chair: Mr. Weissman, be very concise if you can.

Mr. Peter Weissman: I think in 80% of the cases, yes, it's absolutely fair. I think there are some types of corporations where it's not fair and I think to look at corporations in isolation is also unfair. Individuals who have losses can use their losses against all sources of income. Companies, when they have a loss, those losses are trapped inside the corporation, so we could have this debate about what's fair and which way or the other, but I think tax incentives for corporations to grow capital, to provide capital for corporations, is fair.

The Chair: Thank you, all.

I turn now to Ms. Raitt.

Welcome back to the committee.

Hon. Lisa Raitt (Milton, CPC): Thank you very much, Mr. Chair, I appreciate it.

This question is for Dr. Dutt.

I share a common birthplace with you, Cape Breton Island, and this past weekend, Dr. Dutt, I was in Nova Scotia and I actually attended the Doctors Nova Scotia town hall, which was attended by over 400 physicians. What I learned there was that there's a serious concern of the physicians in Nova Scotia about the effect on patient care and health care that will come from these tax reforms, these tax changes, being put into place.

You gave a stat that about 60% of doctors are incorporated. Doctors Nova Scotia tell me that 75% of Nova Scotia doctors are incorporated and it's important for this reason, when they surveyed their membership, they found that 451 doctors out of 864 who responded said that they would consider moving away from Nova Scotia.

Dr. Dutt, you and I, coming from Cape Breton, both know one thing, that there is a serious problem with the lack of family physicians in Cape Breton. You know the outcry from the community and you know the emotion in the community over this, so I was very surprised to hear that your first recommendation, being a physician in Cape Breton, knowing the impact that will have on health care for Cape Bretoners, would be that you would say to the Liberal government to go ahead and implement these things.

I'm wondering if you can tell me why you think these changes will not have an impact on Cape Breton health care when your colleagues in Nova Scotia overwhelmingly say it will.

Dr. Monika Dutt: I appreciate that you attended that meeting. I know it was well attended. I also do know that there were quite a few people there who do support the changes.

It is a difficult environment, I think, to try to bring some of those perspectives forward. I'll just say that, clearly, the sentiment there was against the changes, and I fully recognize that. As we've said in the letter, and I've tried to speak to, there are definitely concerns that physicians have about the system, and it's feeling as if tax policy is not the best way to address those concerns. That's kind of the main reason.

I feel as if coming from Cape Breton influences me even more, knowing the kinds of incomes that my patients have, knowing that I can have a pretty decent income. I work not too many extra hours. I work decent hours. I am on call and I do things that physicians do, but I earn much more than they do. I also recognize that, as physicians, when we're working in a low-income area, we need to look at that aspect also.

I will also say that, given that the medical associations came out so strongly against the changes, and I know because members asked them to, there hasn't been a space to put out surveys that ask if we support the changes. That was never a question on that survey. That's one thing: I think there hasn't been a space to bring that voice forward.

Last, I'd just say there have been many times throughout history when physicians have said that patient care will be harmed, and they'll leave the country or leave the province. There are already challenges to recruiting to small places, to rural places, to places where the pay might be lower than other provinces, and there hasn't been the evidence to show that the tax policy changes will exacerbate that. We've actually seen physicians coming from the U.S. to Canada in recent years, much less than physicians leaving Canada. That's not to say there won't be impacts, but I think it actually harms us when we are trying to negotiate for specific things in our provincial negotiations to make these kinds of threats now that may or may not come to be, because the tax changes likely will come to be, and when we want to try to negotiate for something else later, it gives us a weaker position.

● (1235)

The Chair: I'm trying to leave time here for one more quick question.

Hon. Lisa Raitt: Thank you very much, Mr. Chair.

Mr. Soloman, thank you very much for coming today. I was also in Charlottetown on Friday actually, and I ended up having a chat with your partner, Lloyd Compton, who came to one of my town halls.

Mr. Soloman, what I understand from what I heard in Charlottetown is that the three main industries—and maybe the chair can correct me—are farming, fishing, and tourism. In fact, tourism is about 6.5% of the GDP. Eighty per cent of the people who work in tourism are small businesses. There are 1,300 fishermen who are incorporated in P.E.I., another huge number. Of course when it comes to farms, 98% are family-owned businesses. They're farm families.

Mr. Soloman, I'm wondering if you think this is going to have a disproportionate impact in Prince Edward Island, given the fact that the economy is so intrinsically tied to small business and the impacts this will have on small business.

The Chair: Please speak very briefly.

Mr. Terry Soloman: Yes, certainly P.E.I.'s economy is very much private sector driven, so any changes that will impact the capital that's available for small business are going to have a very negative effect.

I can speak specifically to some of these businesses. All three of those sectors you mentioned are very capital-intensive businesses, with significant risk involved. Frankly, it is extremely difficult to, in many cases, have financial institutions that want to finance growth. These passive proposals.... I know people are saying if it's in a corporation, and it has this deferral.... But sometimes you can't just reinvest it in your business that day. You have to leave it in there for a period of time. Maybe you have to save up for an expansion or the right business opportunity.

It really will impact the P.E.I. economy. Any time you take that much capital out of the economy, it's certainly going to impact it.

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

Go ahead, Mr. Dusseault.

[*Translation*]

Mr. Pierre-Luc Dusseault (Sherbrooke, NDP): Thank you, Mr. Chair.

I thank all the witnesses for their comments.

I will do what Mr. Fergus did earlier and ask a brief question in the hope that you can provide a yes or no answer.

I would like to know if we can begin with the obvious, regarding the possibility that businesses distribute revenue among the members of a family without any requirement that they contribute to the business.

Do you think, yes or no, that it would be appropriate or wise to put such a criterion in place? We may not agree on criteria and modalities, but would it be wise to put in place a requirement that family members contribute to a business so that income may be shared amongst them?

Mr. Weissman, you may answer first.

[*English*]

Mr. Peter Weissman: You want a yes-or-no answer. That's a hard one to give a yes-or-no answer to.

I think it is part of the government's platform. It was something that they were concerned about. I think it's a fair policy objective, as I said before, but I think it's important to have it based on some measurable, quantifiable measure of contribution, as opposed to a subjective test.

Ms. Denise Workun: No, I don't agree with income sprinkling in any form, but I would say on balance that if you're going to allow.... I do think it's important to narrowly define—and not leave ambiguous—reasonable contributions to the business by family members. Absolutely, family members who contribute to a business should be reasonably compensated, but I do agree that very clear criteria have to be set out.

● (1240)

Mr. Terry Soloman: I would concur as well. I do believe that if there is going to be some sort of income sprinkling rule put into the legislation, it needs to be a bright-line test. It should not be a reasonability test.

Also, I believe that a spouse needs to be viewed differently than other family members are. I really do believe that spouses should be looked at as a family unit. In that situation, I do not believe that tax on split income rules should apply. But we're getting into specifics on that....

I do believe that it should be bright-line test.

Dr. Monika Dutt: I'm not a tax policy expert, but my understanding is that part of a comprehensive review should be looking at whether we're taxing individuals versus families and, in looking at that question, doing it in a way that doesn't disproportionately have negative impacts on, say, single parents or others who wouldn't be able to access the same kinds of tax reduction benefits.

[*Translation*]

Dr. Alain Paquet: Yes, I think it would be possible to do that.

We need to avoid ambiguous scenarios where people would again try to directly or indirectly bypass the system. There would have to be guidelines, since the objective is to have a lower tax rate for businesses than for individuals. The entrepreneurs have to face risks that a salaried employee does not face. As such, it is not better or worse in either case. We need all of these people in our economy.

I would like to go back to a question you raised earlier concerning the risks and the synchronization businesses must aim for, i.e. the chronology that demands that a business have funds to meet opportunities that may arise. There too, it's conceivable that there be some way of defining a criterion, such as a percentage—the base of which remains to be determined—of revenue that could be compared to a passive investment, one that would be well framed and would allow the business to take advantage of positive growth opportunities.

However, things would not be as they are now, where even if its objectives do not guarantee its growth nor align well with some situations, a business can still indirectly benefit from lower taxes through incorporation.

[*English*]

The Chair: I'm sorry, but we're going to have to cut it there on that round of questioning. We're into four minutes.

Ms. O'Connell.

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

Mr. Soloman, you mentioned this in your opening remarks, and then on that last question you went further in terms of saying that spouses should be seen as a family unit. You talked in your opening statement about sprinkling of income for those who legitimately work in the business and then even for those who don't. I assume you're referring again to the spouse as that unit.

I have two questions.

One, how could you justify building into a system a benefit for married individuals and leaving out single individuals who would not have that benefit?

Two, if you're referring to the idea that a small business owner, for example, works really hard and their spouse might have to take care of the kids or do something in addition to allow that small business owner to do what they do and put in the hours they put in—because I've heard that argument—I would draw the comparison to not only a doctor, but a firefighter or a paramedic who may have to get up in the middle of the night for a greater community service, but doesn't actually have the ability to sprinkle income to, let's say, a family member or a spouse, in order to be able to do the job and to do the things they do in that position.

Could you elaborate on how you would justify spouses being a family unit despite the inequality in that couple of examples that I've provided?

The Chair: Terry, go ahead.

Mr. Terry Soloman: I guess with respect to your question, as I mentioned in my opening comments, the spouse does contribute to the earnings of the business whether they're directly or indirectly involved. That should establish an entitlement to receive income and not pay tax at the very highest rate simply because they're someone's spouse.

If someone is an employee, you have to do a comparison, and there's been much debate about the other factors involved with these proposals. That's why we need to have a more comprehensive review of the system.

Although I'm not a lawyer, I do know that in the case of family law, a husband and wife are seen to have equal entitlement to the family assets. While I'm mixing tax law with family law, there is a similar theory, in that both spouses are contributing to the economic growth of the family unit.

● (1245)

Ms. Jennifer O'Connell: Thank you.

My next question is for Ms. Dutt.

Again I'm referring to what was reported in the media as some internal documents on messaging from the Conservative Party. In it they asked what Trudeau's taxes will mean. One of the things said that if you need a family doctor, it will be harder to find one as a result of these tax implications.

As a doctor and someone from Atlantic Canada, we've talked about the challenges for the medical profession in terms that it might be different than in other provinces. For example, in Ontario, we have other challenges in health care. Could you speak to whether you think that finding a family doctor will be directly correlated to these tax changes, or do you think there are perhaps systemic issues in terms of the medical care across the country that might be leading to some of the access issues?

Dr. Monika Dutt: I could say two things.

It's been painted as a for or against, and doctors divided, but in the end I often find with physician colleagues who may adamantly oppose the tax changes that we come to agreement. We know that there are problems in the system that we need to deal with. That's often the common place.

We may differ on how to address tax policy, but I fully support my colleagues who work incredibly hard and work long hours. I want to say that.

I think one issue that comes up in this discussion, which isn't going to be solved by tax policy, is the differential in physician earnings between different specialities. Family doctors, emergency physicians, pediatricians are some examples of lower-earning physicians on the spectrum. They are also often the ones who may have higher overhead. A physician who is running their own one-person family doctor practice may be using more of the income they have to run that practice.

Whether we're going to lose physicians, again, I don't know that we have the evidence from the past to say that we will. I will say that there may be differential impacts on some physicians, especially those who may be using these tax incentives to support their businesses rather than as their own savings.

The Chair: Thank you both.

Mr. Poilievre.

Hon. Pierre Poilievre: I'll start with a quick correction.

It has been said that small businesses have a lower tax rate on their passive income. In fact, they pay a higher tax rate on their passive income under the present rules.

Moving on to Ms. O'Connell's remarks, she was commenting on this inequality that she sees in retired business owners sharing their income with their spouses, as though they are the only ones who are able to do that. We have something called pension splitting in this country. For small business owners, with the income, the dividends they take out of the business that they have built throughout their lives, that is their pension.

We public servants all get a public pension, and we are allowed to split that pension. The Prime Minister will be able to split his government pension with his spouse for the express and sole purpose of lowering his tax burden.

Do you think that's fair?

The Chair: Who wants to answer this?

Ms. Denise Workun: I'll answer that.

I did proactively address that issue in my opening comments. I think that's absolutely not fair, and that should be changed as well.

The Chair: Mr. Paquet.

Dr. Alain Paquet: On the point raised by the honourable member, the difference is that a small business owner or a bigger business owner who are incorporated would be able to compound that interest for a longer time, without paying taxes, than the retiree who has been a salaried worker for all his life. So all of the interest payments, the compounding of interest, will give him a higher return.

Hon. Pierre Poilievre: I'm aware of that, sir.

Dr. Alain Paquet: It's important to point out.

Hon. Pierre Poilievre: I'm aware of that but what was stated on the panel by one of the witnesses is that passive income is taxed at a lower rate within a private corporation. That in fact is not true. It is taxed at a higher rate within a private corporation. That is the correction I was making.

Does anybody else want to comment? I want to state clearly that I support pension splitting. I was part of the government that brought it in, but the government is taking away pension splitting for small business owners. Do you think it's consistent that members of the government bench will be able to split their pensions with their spouses when they're taking away that opportunity from small business owners?

● (1250)

The Chair: Mr. Weissman and then Mr. Soloman.

Mr. Peter Weissman: I think it is fair given the context that there is pension splitting to employees. I think that income sprinkling is a form of income sharing among business owners. I do think if there's going to be fairness in the system, the two should be allowed.

Hon. Pierre Poilievre: Just to clarify, under the government's proposal, there is one way that the retired couple could continue to split their income, in fact, would be required to split their income, and that is if they get a divorce, in which case the Divorce Act would require that they divide up their assets and therefore their income.

The Liberals will allow it for people who have a company or a government pension. They will require it for divorced couples but they will ban small business owners from dividing up their effective pension assets for the purposes of minimizing their tax bill.

The Chair: I remind you, Pierre, this is a proposal. It is not the Liberals that are doing anything as yet. There's a proposal that there are consultations on, so let's not forget that.

Mr. Soloman, did you want to answer?

Mr. Terry Soloman: I just want to make a couple of brief comments on that issue.

I have heard some suggest that while a business owner could contribute to an RRSP, they would then be able to income split as well. That is a fair comment. However, I'm going back to that family that makes $50,000 to $100,000 a year. They're trying to grow their business. They just do not have the excess cash to be able to fund their RRSP at least in the early years. Many businesses actually refer to their business as their retirement plan. It is their RRSP.

I just don't think you can look at a pension that's built up over many years and compare it to a business and say that one should be income split and one should not. I think the two are hard to compare. I don't believe that the private sector business owner in many cases has enough time to build a pension that would be equivalent to a defined benefit pension that maybe a public sector employee would be entitled to.

The Chair: Okay, thank you.

Mr. Sorbara. We're going to cut back. We need three questioners. You're only going to get three minutes, so be snappy, no speeches.

Mr. Francesco Sorbara: Okay.

Thank you, Mr. Chair.

Thank you everyone for being here today.

I want to go to Mr. Weissman first.

I've met with many of your colleagues in the tax industry to go over these proposals and better understand how we can make the system better, how we can improve tax fairness, tax efficiency. Are there issues in the spirit of what we put forward in the consultation paper that may address some of the issues in terms of tax fairness?

Mr. Peter Weissman: As I said earlier, I think some of the proposals are in line with the government's policy intent and with the platform they ran on, and I think those are workable. I think there's overkill in the proposals the way they are. They're just unwieldy. Unfortunately, the most dangerous pieces of these proposals are buried. No one understands them except the tax practitioners, and no one is talking about them.

Mr. Francesco Sorbara: Mr. Soloman, would you answer the same question, please.

Mr. Terry Soloman: I would agree as well. I believe there are aspects of the proposals that have merit. I mentioned before that some of the proposed changes to section 84.1, for example, I could support. But in many of these situations, it's fact specific as to whether each individual proposal is having too much collateral damage to deal with an issue that's trying to be dealt with. The proposals end up capturing things that were not intended, or in my view they weren't intended.

Mr. Francesco Sorbara: Thank you.

I'm finished, Mr. Chair.

The Chair: You were really fast.

Mr. Albas.

Mr. Dan Albas: Thank you to all of our witnesses for your testimony today. It's very helpful.

Further to Mr. Fergus's line of questioning earlier about whether there are certain advantages and whether or not the system is fair, I would make sure it's on the record, Mr. Chair, that it's very much akin to our highway or public transport system. Some people choose to use a car because it fits their needs. Some people choose a van or a larger truck. They have different features. Obviously we require trucks to stop over and put on chains in certain areas and to comply with certain documentation, because of how they are used and there should be more checks and balances. This is not a matter of whether something is advantageous or not. This is a question of what feature they're operating under.

Concerning TOSI, the tax on split income, I want to talk to Mr. Weissman.

Mr. Weissman, these rules are well established. The government's own document just says it's not winning at court enough. That's why it's putting on these reasonableness tests. There's no definition of what is reasonable. It's going to end up being ultimately the court that decides what is reasonable, given the law.

Do you feel that CRA has the capacity to handle this increased scrutiny of tax on split income?

● (1255)

Mr. Peter Weissman: Given CRA's resources now, I do not think they will be able to handle this. CRA is having difficulty handling tax matters as they are now.

I feel badly for the CRA employees, but there's an influx of audit work going on. Those audits are not resolved satisfactorily because of subjective issues. They go to appeals. The appeals division has a finite number of people to manage the appeals. We're waiting six to nine months to even be assigned to an appeals officer these days.

Mr. Dan Albas: Okay. Some $250 million is what the government thinks it will get from these new rules. Do you think they will get that, based on the increased cost of seeing more of these things going to court?

Mr. Peter Weissman: In fairness, it's not a question I can absolutely answer. My gut feeling is that it will cost more than it will benefit.

Mr. Dan Albas: Thank you.

Dr. Dutt, thanks for your testimony.

I've spoken to a number of people in my riding. First of all, whenever I'm in Keremeos, Cawston, Princeton, Logan Lake, or Merritt, the first thing mentioned is doctor recruitment and doctor retention. I've spoken to doctors in the Princeton area who have said that these current rules will incentivize them to no longer work in a clinical setting, but instead go to places.... One doctor in Summerland said they'll stop working in the clinical setting and go to emergency or work for Medeo, which is like a Skype service for medicine.

Will that affect the way patients interact with their doctors, and is that good?

Dr. Monika Dutt: I want to comment on your analogy, which I thought was interesting, because the people who tend to use public transit are often lower income and often unable—

Mr. Dan Albas: —and often are subsidized. Could we focus on my question, because I'm asking you specifically as a doctor?

Dr. Monika Dutt: But it's relevant to this issue, because it speaks to who can access what types of benefits. I just want to point that out.

To respond to your question, I think it has been a good conversation concerning the best way to pay physicians. Initially physicians didn't want to be salaried, when medicare was first created; they fought very hard against that. What seems to be coming up now is that physicians want to be paid in various types of models, because our current way of paying many physicians isn't working.

Mr. Dan Albas: I'm not talking about how they're being paid, ma'am. I'm asking whether—

The Chair: I'm sorry, Dan.

Mr. Dan Albas: —this will have a marked effect on clinical operations between—

The Chair: Order. Dan, order.

Mr. Paquet wanted to give a quick answer, and you're over time.

Mr. Dan Albas: No, I would like to find out out what effect it will have on clinical experience, Mr. Chair.

Dr. Alain Paquet: Thank you. I would like to add quickly, Mr. Chair, concerning doctors who have had experience in Quebec, in which we gave [*Inaudible—Editor*] and it doesn't increase the number of doctors practising. We had to take other measures to do that.

On the contrary, I don't think the change would decrease the availability of doctors. I think the experience of Quebec speaks for itself in that regard.

The Chair: Your point...?

Mr. Dan Albas: Mr. Chair, I was simply asking her to see whether or not this will affect the way people interact with their physician in a clinical setting. Will there be positive or negative impacts?

The Chair: Could we have a quick answer on that, Ms. Dutt?

Then we're going to Mr. McLeod.

Dr. Monika Dutt: I would say it will affect the way physicians are able to engage with our provincial organizations and federal government to create a better environment for both doctors and patients.

The Chair: Dan, we're done.

Mr. McLeod.

Mr. Michael McLeod (Northwest Territories, Lib.): Thank you, Mr. Chair.

Thank you to the presenters today. It's a very interesting discussion. Of note, of course, is that we're at the consultation stage, with no registration written yet. Of course, we all recognize that the tax system is very complex and many, many pages long. I've heard many concerns over the last while about how the system needs to be fair, and it needs to be balanced. I think we all agree that it needs to allow for growth, and it needs to allow for retirement. Some people have raised concerns that the proposed amendments don't go far enough. I heard the points being made about how tax credits that I would think were designed to encourage growth for the company were being viewed as the way to plan for strategy for families' retirement. Now, I would think that the mechanisms that are in place, such as RPPs and RRSPs, would be something that would be used as they are by everybody else, but I'm hearing different things on that.

Maybe I could ask you to explain how you see that.

● (1300)

The Chair: Who wants to answer? Are there any volunteers?

Mr. Soloman and Mr. Weissman.

Mr. Terry Soloman: Thank you, Chair.

It's a great question. Certainly business owners can utilize the RRSP system for contributing funds to their RRSP for their retirement. However, when you contribute to an RRSP, you lose flexibility if one of the goals of holding the money inside a corporation is for future expansion or working capital. It's not easy to just take the money back out of the RRSP at that time. Many business owners do make the decision that in lieu of an RRSP, they will do what I would call a corporate investment strategy, which is really multipronged. Part of it is for business growth and part of it is for retirement, but it's primarily a flexibility issue. It works better in some situations.

The Chair: Mr. Weissman, you can have one last comment.

Mr. Peter Weissman: I think that the question you've asked oversimplifies things. Yes, money is retained in companies to fund retirement. It's also retained in capital-intensive companies for expansion, for downturns, etc.

As I said earlier in my opening comments, there are some types of corporations that don't need to accumulate as much reserve. Professional corporations, for example, which I thought were the target of the government's election platform—and many of my colleagues will not be happy with me saying this—do not need the same kind of capital retention that normal family businesses do. There are ways to address that much more simply than through what's been proposed in what we're told is the consultation stage. This is not like any consultation stage I've ever seen in my career.

The Chair: Thank you very much. That will end this panel.

I want to thank each and every witness for coming forward and answering questions as directly as they can. I also thank the members.

We will have to suspend for a couple of minutes and then go in camera to deal with a budget for this study or people who come from afar will be shortchanged.

[*Proceedings continue in camera*]