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2017.09.29

Hon. Bill Morneau
Minister of Finance
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Dear Minister Morneau,

Further to the Department of Finance's consultations on the tax changes proposed in the white paper titled "Tax Planning Using Private Corporations," please find enclosed a report containing submissions from stakeholders from Manitoba, Nova Scotia and Calgary.

The people I met with warn that the proposed changes will cause or have already caused: capital flight from Canada, cancelled plans for business expansion and hiring within Canada, uncertainty for family-owned enterprises, undue hardship in retirement planning for small business owners, including incorporated professionals, and tax barriers which prevent the intergenerational transfer of businesses like farms.

I urge you to abandon the proposed changes and instead fulfill the Liberal Party's platform promise of lowering the small business corporate tax rate to nine percent and return to a balanced budget.

Sincerely

Pat Kelly, MP
Calgary Rocky Ridge

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In September 2017, I hosted or attended formal roundtable meetings in Halifax, Port Hawkesbury, and Sydney, Nova Scotia; Calgary, Alberta; and Winnipeg, Manitoba at which I solicited input on the proposed tax changes. I also attended various informal community events at which constituents approached me to provide input on the topic. I received numerous emails and telephone calls on the subject, which my staff documented to contribute to these submissions. In the week of September 24th, 2017, I collated the streams of input into this report.

Note: responses have been edited for brevity, have not been weighted according to frequency of submission, have been condensed if duplicate, are presented here as reported by stakeholders, and are presented in no particular order.

Conclusions:

- Dividends are not synonymous with wages or salary. They compensate for risk assumed, not necessarily labour performed. Paying dividends to family members from family-owned businesses is justified given that all family assets are at risk for the company and thus all family members bear risk. Punishing companies for paying dividends to adult children discourages inter-generational skill transfer and ignores the risk that they bear.

- Small businesses do not incorporate to evade taxes. Some incorporate as a requirement for obtaining insurance, bonding, etc. and operating in given industries.

- Many small business startups are capitalized by mortgages on family homes, private borrowing from extended family members, and risking private assets. They are built from the ground up by owner/operators who pay their taxes.

- Disincentivizing work through higher taxes on income will result in less work, less economic activity, and fewer jobs. Business which can leave Canada will. Those which cannot leave will cut wages, hire fewer workers, or downsize.

- Income and wealth are very different. Small businesses often experience years of losses before growing enough to make a profit. Punitive taxes on higher income and passive investment later disincentivizes taking risks with startups earlier.

- Disincentivizing investment through corporations will diminish the amount of money available to other Canadian companies looking to raise capital. It contributes to a hostile tax environment for businesses and prompts capital flight to friendlier jurisdictions. This diminishes Canadian companies' competitiveness and costs jobs.

- Abruptly changing the rules on passive income for corporations pulls the rug out from under those who rely on those rules to fund their retirements since they do not enjoy employee pensions, CPP, or RRSPs.

- Proposed changes which may a one-time sell-off could trigger a run on the TSX, a real estate market crash, and/or a recession if billions of dollars in corporate asset conversions and partial liquidation to pay the taxes thereon take place in a short period of time.

- The consultation period for the white paper is wholly inadequate. Changes with such wide-ranging and serious effects should only be phased in over many years to allow people who have relied on the rules to adjust.

- Removing the dividend tax credit results in unfair double taxation on dividends, results in an effective tax rate of 73% tax on most dividends, and defeats the purposes of integration between corporate and personal income taxes.

- The Prime Minister and the Minister of Finance do not understand small businesses and the disincentives the proposed tax changes will create for them. Likewise, they have either failed to grasp foreseeable negative effects on small business owners and employees, or they intend them despite rhetoric to the contrary. If they truly want to hear from Canadians about the proposals, they should be open to abandoning them.

<u>Evidence from Canadains:</u>

<u>The purpose(s) for which an enterprise incorporated:</u>

- “In the construction industry, we cannot trade unless we are incorporated.” – Shelley Morin, Calgary

- “The truth is that the MAIN reason to set up a corporation is to insulate the owners of a business from litigation or to afford creditor protection to certain business assets. For example, it is common to separate real estate from the operating business (in separate corporations) in order to protect the real estate assets. It is not, as you think, to primarily reduce/defer taxes.” – Chris Wutzke, Calgary

The effects of the proposed tax changes on capitalization of Canadian enterprises:

- “The tax regime changes proposed by the Liberals affect ALL small business owners, not just a few “abusers” as their leaders have suggested. The Liberals are impacting a major sector of the economy, not just a few wealthy tax evaders as they have suggested. In the face of such uncertainty, investment by this major sector will stop.” – Dennis Seidlitz, Calgary

- “These changes will hurt all Canadians. Those with the means will take their capital to more competitive tax jurisdictions and the underground economy in Canada will continue to grow.” – Shelley Morin, Calgary

- “The tax rules affecting corporations are so onerous, and thus expensive from a planning and compliance perspective, that I advise clients to avoid creating new corporations unless there is a clear business reason to do so.” – Chris Wutzke, Calgary

- “We survived 2008 and 2016 by reducing spending, having no debt and by keeping retained earnings in our company. Your tax plan penalizes a business for following the most basic of defensive business strategy – saving.
  We were exploring setting up in Ontario near the US border to better support and grow our US business. We are now looking at Denver, Ohio or Pennsylvania. The return does not justify putting capital at risk in Canada with your proposed tax changes.” – John Forgeron

- Attendees at the Sydney Chamber of Commerce roundtable emphasized that Nova Scotia already has prohibitively high taxes, so raising them on small businesses like incorporated professionals will drive the latter out of the province and exacerbate a shortage of doctors, dentists, and specialists.

- A CPA informed a town hall meeting that he has given advice to clients planning to move over $1 billion in investment out of Canada since these consultations opened. He pointed out that he is merely one accountant at one firm. If his experience is representative of his profession, capital flight is already well underway.

The effects of the proposed tax changes on anticipated expansion or contraction of Canadian enterprises, and/or on competitiveness:

- "In the real world of competitive business, we cannot simply raise prices or 'collect taxes' for budget short comings. We cut spending or go bankrupt, which may happen due to double taxation and punitive tax changes." – Shelley Morin, Calgary

- "If the government goes through with these changes, I, and many of my colleagues, will work less. I will ask my accountant to advise me of that dollar figure that makes it no longer advantageous and, in fact, disadvantageous to work more. When I reach that number, I will stop working." - Shunaha Kim-Fine

- "In order to compensate for higher operating expenses in the form of increased tax, small business owners will have to lower wages and increase prices. The trickle-down effect will certainly be felt by more than just small business owners. It seems like poor economics to bite the hand that feeds you as well as the vehicle that employs a large portion of Canadians." – Sean Freiberg, Calgary

- "These changes will ensure that many small businesses, mine included, will not be able to hire as many employees." – Don Martell, Arichat, Nova Scotia

- Dr. Charlotte, a dentist in Sydney, Nova Scotia, told me that the proposed tax changes will drive her out of the province in search of a less hostile tax environment, taking jobs in her clinic with her, and reducing medical services in an already under-served town. Also, by making it much more difficult to save to cover maternity leaves, these changes will deter female entrepreneurs and professionals.

- Jay Cardell, an accountant in Calgary, told me that the class warfare against small businesses and proposed tax changes will diminish incentives to work hard and be successful. Less work means less economic activity and fewer jobs.

- Dr. Mary Noseworthy, Asthma Director at the Alberta Children's Hospital, moved to Calgary from Newfoundland ten years ago and has not been replaced in her old hometown. Tax changes will prompt professionals to leave Canada, exacerbating an existing shortage of physicians and specialists, especially in smaller towns. This is especially true for female doctors who must fund their own maternity leaves from corporate savings.

<u>The effects of the proposed tax changes on financial and retirement planning for owners of Canadian enterprises:</u>

- "For a very significant number of small business owners, their company is their pension." – Dennis Seidlitz, Calgary

- "Our retirement is in our holding company." – Shelley Morin, Calgary

- "Our pension is what we can build as equity in our business. If that opportunity to catch up once income is higher [by holding passive investments in the company] is taken away, then there will be no pension. Period." – Bill Leesman, Calgary

- "When I was on maternity leave (only 3 months) and I was still paying $12K / month in overhead (for nurses, admin staff, etc., who I employ), it was helpful to know that I had sheltered some money in the corporation to pay myself and my employees to keep the practice going. The strategy of trying to improve government income with these changes will be catastrophic for the financial industry as many individuals have invested large sums within their corporations for the purpose of funding sick leave, maternity leave and retirement." – Shunaha Kim-Fine, Calgary

- "The proposed rule changes to passive corporate income, and to capital gains, will erode wealth away from the living, breathing, working middle class and hand it over to a government that has yet to form a concrete plan to provide growth and prosperity for all Canadians." - Darris Cameron, Calgary

- Andy Ross, a management consultant in Calgary, told me that he has relied on existing tax rules since starting his small business in 1999. Changing the rules now undoes 18 years of saving for retirement, self-funding insurance for slowdowns and work shortages, and sharing parenting responsibility with his wife so that he can travel for work.

- Scott Kraft, a neurologist in Calgary, mentioned that, unlike employees, he does not enjoy tax-sheltered savings like RRSPS or matched contributions to CPP. Investing passive income through the corporation is his retirement strategy, a strategy which will be ruined if the proposed changes to passive investment are made. He now considers leaving Canada.

<u>The effects of the proposed tax changes on succession planning for family-owned Canadian enterprises:</u>

- “Under your proposals, if a business owner tries to sell their shares to their children in 2018, the capital gain will be taxed at a high rate as a dividend, whereas if the shares are sold to an arm’s length party, it will be taxed at a lower rate as a capital gain. This sounds more like discrimination than tax fairness.
  Why do you need discriminatory rules focused on 18 to 24 year old children of business owners challenging their work with the company, when anyone else’s children would entirely avoid such scrutiny? Are you trying to disincentivize intergenerational teaching and business succession?” – Chris Wutzke, Calgary

- “I am a long-time Liberal voter, and am totally disgusted by yours and your party's attempt to 'close tax loopholes'. You ran on a platform as standing for the middle class. This particular policy is going to do nothing but punish the middle class and destroy family-owned businesses - particularly those hoping to pass them down through generations.” –Susan McEvoy, Calgary

<u>The proper role and use of dividends in CCPCs:</u>

- “Income ‘sprinkling’ at a certain level is appropriate given the fact that a small business owner often ends up pledging/risking his home and all his family assets to obtain financing. It impacts his whole family.” – Dennis Seidlitz, Calgary

- “We paid ourselves through dividends when building our company, since the cash flow was tight. Our family has sacrificed enormously to build our company; all of the personal guarantees could adversely affect the family home, including all members of the family, if we fail.” – Shelley Morin, Calgary

- Mathieu Dery, a real estate associate in Calgary, asked what he and his family would do now. If a reasonableness test is brought in for dividends paid to his family, whose assets are at risk with his business, it will create years of uncertainty and fear of CRA audit for an honest business.

- Richard Presland, an accountant in Calgary, told me that he uses dividends to pay his wife for the value she adds to the business from home. Her role is not clearly defined, but she assumes much risk and contributes to the company.