ESAM
Environmental Services Association Maritimes

September 26, 2017

The Honorable Bill Morneau
Minister of Finance
House of Commons
Ottawa, ON K1A 0A6

Re: Proposed Tax Changes for Private Corporations

Dear Minister Morneau,

On behalf of the members of the Environmental Services Association Maritimes (ESAM), I am writing to express our concerns with the proposed changes to the tax legislation affecting the owners of Canadian Controlled Private Corporations (CCPCs). Understanding the stated goal of ensuring tax fairness for all working Canadians, we would like to offer constructive suggestions on how the proposals can be changed to better achieve this goal.

We have reviewed the proposed changes and consulted appropriate counsel to understand the implications of the proposed legislation for our members, many of whom are small business owners. These entrepreneurs are established professionals who have identified an opportunity in the marketplace and taken significant risk to pursue this business opportunity. In doing so, many have left successful careers, or turned down opportunities with large engineering firms or government organizations that provide stable income, benefits and pension plans. In most cases, they have also invested risk capital in establishing and growing their businesses, provided employment for others, and otherwise helped to grow their local economies through their business expenditures. The new proposals as presented fail to provide appropriate consideration and flexibility to address the risks and costs involved in these private business ventures.

The three specific measures proposed each have issues and implications associated with them that will make it harder to justify the risk of entrepreneurship, and thus, will discourage current and future small business owners from starting and expanding businesses:

- **Family income splitting**

  Entrepreneurs take significant financial risks, which affect their entire families through the pressures of income variability, potential loss of family assets and income, and the stress of economic uncertainly. The long hours put in by most entrepreneurs (which are almost never limited to business hours) often means the spouse must take on full responsibility for family obligations, which can severely limit his or her ability to earn income independently. Income splitting is a way for entrepreneurs to make up for some of this economic uncertainty, and to balance the tax treatment of single income earners compared to dual income earners with the same total income.

- **Passive investment income inside the corporation**

  There are several reasons why the ability to retain income in investment reserves within a private corporation is very important for private corporations:

  - These reserves, and the income they provide, serve as insurance against business downturns, which often happen unexpectedly due to external economic, social or political influences;
  - These reserves provide a lower risk and more readily-available source of capital for expansion than debt financing, which can be difficult and time consuming for small businesses to attain when needed, especially in difficult economic times; and
  - Small business owners do not have access to the group benefits and pension plans of many salaried employees, and must entirely self-finance benefit plans, employment insurance, sick days and vacation time. Passive investments within the business help the owner to prepare for retirement. This is a reasonable use of the corporation, given that most entrepreneurs do not earn significant incomes in their first 10 years or more in business, and so have little or no retirement savings or RRSP contribution room. Given the late start in retirement savings necessitated by the launch and growth in the company, entrepreneurs need a way to more quickly build a reasonable retirement fund, which investment through their corporation provides.

- **Converting income to capital gains**

  Passing on a successful business to the next generation is the goal of most small business owners. Limiting the ability of entrepreneurs to enter into legitimate intergenerational business transfers, and in fact, putting them at a disadvantage in doing so compared to selling to a non-related party, will only make it more difficult for business owners to realize on their hard work and investment. It will also result in more rural small businesses closing or moving, a lower standard of living for many entrepreneurs in retirement, and lower overall economic growth.

The rhetoric around these proposed changes painting small business owners as the “super-wealthy” is discouraging, disappointing and very far from the truth. As a business person with a depth of experience in family business, you must understand the financial and personal risks entrepreneurs take to pursue their dreams. You must also understand the uncertainty of income, the frequent lack of benefits, and the lack of a pension plan that entrepreneurs face. It is generally well known that half of all new businesses close down in the first five years of operation. It is probably less well known that two-thirds of small business owners make less than $73,000 per year. The ability to realize some efficiencies from tax planning is a partial offset to the risks and financial sacrifices made by small business owners, who often struggle for many years to make their businesses profitable.

To remove the tax planning benefits available to small business owners when they do overcome the odds and start to make a reasonable return on their investment would serve as a significant deterrent to prospective entrepreneurs, and will likely convince many current business owners that investment in growth initiatives is not worth the risk in light of the reduced opportunity for after-tax return. It will also provide another reason for budding entrepreneurs to decide not to take the risk of entrepreneurship, which would be a real loss for our economy and country as a whole.

The existing CCPC tax structure was established to encourage entrepreneurship by offsetting a portion of the risk associated with operating a small business. The increase in the number of CCPCs is a testament to the effectiveness of the tax planning benefits. It is therefore unreasonable to suggest that the proposed changes would not negatively affect Canadian entrepreneurship.

In order to balance the goal of ensuring high-income small business owners pay a fair share of taxes, while minimizing the impact on the majority of small business owners who earn modest incomes, we suggest the following modifications to the existing proposals:

- Set reasonable limits for income splitting that recognize and reward families for the joint risks they take in supporting a small business owner;
- Set a reasonable limit for investment income within a corporation based on the potential need of a business for growth capital or reserves to cushion business downturns; and
- Establish reasonability tests and guidelines to determine if an intergenerational transfer of ownership is a legitimate business transaction or an arrangement of convenience to convert business income to capital gains.

Developing the appropriate limits and tests to make the modification suggested above work appropriately will be difficult. However, business is difficult, and governing is difficult. It is in working through the difficulties that we find solutions that will create value for all Canadians, rather than destroy value for hard-working entrepreneurs and their employees and suppliers. If you are indeed interested in developing strategies that work for both government and business, it is imperative that these be developed jointly through meaningful consultation and direct input from the business community, to ensure the desired outcomes are achieved. Sourcing tax planning professionals with expertise in providing advice to small business owners who are willing to help develop these limits and tests would not be difficult.

Finding these compromises will have the intended impact of ensuring the highest income business owners pay a fair share of tax, while ensuring middle-income business owners are not unduly burdened. This approach most effectively addresses the issue of fairness, while still providing incentive for the investment of risk capital in growing small businesses, which provides greater economic opportunity for families and communities.

The message of ensuring all Canadians pay a fair share of taxes on income, especially with regards to the highest level of income earners, is no doubt popular amongst the electorate. The general public hear words or phrases like “loophole” and “tax fairness” and picture greedy, rich people bilking the system. The reality is that these abusers of the system are quite a small percentage. Actions taken to prevent a relatively small number of high income earners from avoiding taxes should not result in an unfair burden on the vast majority of entrepreneurs, who are low to middle income earners, and who pay at least a fair share of tax when reasonable adjustments are made to compensate for risk to capital, income variability, lack of access to pension programs, self-funding of benefit programs, sick days and vacations, the difficulties of accessing growth financing and other factors impacting entrepreneurs.

On behalf of the small business owners within the Environmental Services Association Maritimes and other small business owners across the country, I intreat you to extend the consultation period and engage in meaningful consultation with business community, and to consider our proposed changes to the tax proposals, which will help achieve the stated goal while avoiding the collateral damage to middle-class entrepreneurs and our economy.

Sincerely,

Tara Oak

President/Chair

Environmental Services Association Maritimes

cc. Hon. Justin Trudeau, Prime Minister of Canada
Hon. Bardish Chagger, Minister of Small Business and Tourism
Mr. Andrew Scheer, Leader of Her Majesty's Loyal Opposition
Premier Stephen McNeil
Premier Brian Gallant
Premier Wade MacLaughlan