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Chair

The Honourable Wayne Easter

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● (1535)

[*English*]

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

We have witnesses this afternoon as we're looking at Bill C-74, the budget implementation act—to keep it simple—based on the budget of February 27, 2018.

We'll begin with the witnesses who are before us, starting with you, Mr. Macdonald, for the Canadian Centre for Policy Alternatives.

Mr. David Macdonald (Senior Economist, Canadian Centre for Policy Alternatives): Thank you, Mr. Easter, and thank you to the committee for the invitation to speak today on Bill C-74.

Overall, I believe that this was a positive budget, and this implementation bill of that budget reflects items that the Canadian Centre for Policy Alternatives has been advocating for through its alternative federal budget for several years.

The gender analysis in particular was a strong and important addition to the budget process, but in my limited time here today, I'd like to focus on two items: the new Canada workers benefit, and the closure of tax loopholes used by a small number of private corporations.

With respect to the working income tax benefit and its transformation into the Canada workers benefit, I commend the budget for the decrease in those living in poverty by about 70,000 due to this measure. I believe this builds on other measures, including the Canada child benefit and the guaranteed income supplement, which, when fully implemented, will lift roughly 500,000 Canadians out of poverty, although three million to five million Canadians live in poverty, depending on the year and the measure, so there is plenty of work to be done.

Eliminating poverty in Canada remains an important and worthy goal. Tracking how measures impact it should be part of budget reporting, as it was in the case with the Canada workers benefit, but it's not always the case.

I believe the automatic enrolment feature of the Canada workers benefit is a crucial if underrated change in this program. It's a seemingly small change, but a very important principle, and far from universal in federal benefits. I hope the committee agrees that automatic enrolment should be extended across all federal transfer programs, not just in the Canada workers benefit.

Transfers should not have to be applied for, given that for many the only requirement is inadequate income, which is often already known by the CRA. I encourage the committee to conduct an investigation of any federal transfers or benefits where take-up rates are not 100% and determine how we could get there. One place to start is the Canada child benefit, which is not universally received by low-income families in first nation communities due to low filing rates on reserves.

With respect to the Canada workers benefit, the one item I am concerned with is the potentially dangerous distinction between “deserving” versus “undeserving” poor. At present, support for low-income families is not universal. Only those families who work, or who have children, or who are seniors “deserve” support. If you can't work, federal support is almost non-existent. The only support that a family would receive through the tax system is the GST credit, which is worth at most just under $300 a person.

One of the particular groups that falls between the cracks is that of those aged 50 to 65 who no longer have children and live alone, either in a couple or not. They don't receive the Canada child benefit, as the children have moved out, and they don't yet receive seniors' supports because they're not old enough. Poverty in this group is driven by high disability rates that skyrocket in this age group, either because those folks have worked hard, have been injured, and can no longer work, or because they are caring for spouses who can no longer work. Often, these families see big improvements as they turn 65 and gain access to important programs, such as old age security and the guaranteed income supplement, but in the interim, those Canadians often end up on social assistance, and in most provinces, at rates that are often inadequate.

In our alternative federal budget, we have examined the possibility of extending the GST credit and creating a top-up to the GST credit to support the lowest-income Canadians and also to capture this key group that currently falls through the cracks. This top-up would be worth up to $1,800 a person, but would be reduced more quickly than the GST credit to focus the benefit on the lowest-income families. I encourage members to read a more detailed analysis in our alternative federal budget.

In terms of the closure of the income sprinkling and passive income tax loopholes for private corporations this year, I would express my support, as I have in the past. I think there are clear equity implications, in that wealthy individuals who are paid in particular ways could reduce their tax bill while regular wage earners could not, and those regular wage earners would end up picking up the tab through taxation for the government services that we all enjoy.

It is clear that these abuses were restricted to a small group of private corporations, with a few small businesses actually affected, although I see little economic reason for lowering the small business tax rate as some form of compensation. The small business tax rate is built for one reason—to encourage the reinvestment of profits into the business instead of them being withdrawn by owners.

Neither income sprinkling nor the use of private corporations as a store of passive income have anything to do with reinvestment in the business and are merely ways of reducing personal taxes. As such, their closure would have little impact on business decisions to reinvest profits. If anything, the now larger disparity between the small business tax rate and the general corporate rate will likely further encourage other forms of aggressive tax planning, such as the ones that were just closed.

More broadly, I hope that this committee will focus on tax loopholes, not just with respect to private corporations but in a more wholesome examination of tax expenditures. I hope the committee will continue its examination of who benefits from tax expenditures, and continue to evaluate tax expenditures as if they were program expenditures that should undergo the same type of analysis. Not only that, but also examine the distribution analysis of tax expenditures with the goal of closing those tax expenditures and raising more money for other programs and other public services.

I thank the members for their time and I look forward to your questions.

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

We are turning to Mr. Russell, President and CEO, Investment Industry Association of Canada. Welcome, Ian.

Mr. Ian Russell (President and Chief Executive Officer, Investment Industry Association of Canada): Thank you, Mr. Chair, and members of the committee. It's a pleasure to be before you this afternoon.

[*Translation*]

I am grateful for the invitation to come before this standing committee to present the views of the Investment Industry Association of Canada, the IIAC, on Bill C-74, An Act to implement certain provisions of the budget tabled in Parliament on February 27, 2018 and other measures.

I will focus my remarks on part 1 of the bill and, more particularly, on the sections that pertain to passive investment income, the refundability of taxes on investment income, and income sprinkling.

The principle focus of our remarks is on the impact of the private corporation tax proposals on the capital formation process for new and emerging small businesses. Recent budget changes to the tax proposals have given small businesses qualifying for the small business deduction greater flexibility and scope in managing financial investments.

On the other hand, private corporations are still discouraged from building financial assets and engaging in small company financing and merchant banking activities.

● (1540)

[*English*]

Under the first feature of the tax proposals, the availability of the small business tax deduction—namely, the eligibility for a preferred corporate tax rate of 10% on the first $500,000 of qualifying active income—will be phased out for CCPCs and their associated corporations that exceed the $50,000 threshold for passive investment income in the taxation year. This will be achieved by a sliding scale that will reduce the small business deduction by $1 for every $5 in active income.

This phase-out mechanism limits the availability of the small business tax rate completely once the passive income threshold reaches $150,000 a year. While this is a simpler approach than previously, the inability for many companies to qualify for the preferred corporate tax rate, unless the passive income is below the $50,000 level, unfairly penalizes small business owners by limiting holdings of passive investments to meet unforeseen contingencies, to purchase corporate assets or property, and to expand business operations.

The second feature limits the refundable taxes that private corporations receive on the amount of certain dividends. Under the current policy, private corporations qualifying for the preferred corporate tax rate, or businesses taxed at the general corporate tax rate, are entitled to a refund of taxes paid on dividends from passive investment income. However, the budget provisions effectively limit the tax refund to non-eligible dividends from passive income. While the new proposals are an improvement, this approach will increase the administrative burden for small firms that will now be required to establish separate accounts for eligible and non-eligible dividends.

We urge the government not to proceed with the passive investment income tax proposals. The government estimates that the proposals will affect less than 3% of private corporations, or about 50,000 companies. However, we have little idea of how important these companies are to the Canadian economy. They may be among the largest and more dynamic in the country. In our view, if the government does proceed, the passive income holdings should be grandfathered in determining eligibility for the small business deduction, and the sliding scale should be indexed to inflation.

Our third feature relates to the income-splitting rules. We believe, here, that the government should consider further amendments to the rules, or at a minimum delay the implementation to give greater clarity on the rules and give time for small businesses to comply with the rules.

There are some complicated aspects of these particular income-splitting rules.

[*Translation*]

The substantive adjustments to the tax proposals for private corporations illustrate the new rules were introduced too quickly and with insufficient analysis. If the government proceeds with its modified new tax rules, we recommend it closely monitor the impact on expansion of existing, growing private corporations, and migration of these businesses to the United States. Canada can ill-afford the loss of available capital for small and mid-sized businesses.

Thank you very much for your attention.

● (1545)

[*English*]

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

We turn now to the Canadian Cancer Society, with Mr. Cunningham, Senior Policy Analyst.

Go ahead, Rob.

Mr. Rob Cunningham (Senior Policy Analyst, Canadian Cancer Society): Thank you very much, Chair.

[*Translation*]

Thank you for giving me the opportunity to testify today.

[*English*]

The focus of my testimony will be part 2 of the bill, clauses 47 to 67, implementing a $1-per-carton increase in tobacco taxes and modifying the inflation indexing for tobacco taxes from every five years to every year. We applaud these measures and urge all committee members to support these provisions. Tobacco products remain the leading cause of preventable disease and death in Canada, killing 45,000 Canadians annually and causing about 30% of all cancer deaths.

We also strongly support the federal budget provisions that provide increased investment in the federal tobacco control strategy. This is essential as part of the efforts to meet the objective of reducing tobacco use to under 5% by 2035. There are still more than five million Canadians who smoke. There are teenagers starting to smoke every month. We have made considerable progress, but enormous work remains.

The budget measures regarding tobacco taxes and funding of the strategy are complemented by Bill S-5, adopted at third reading by the House of Commons last week, and by pending regulations for plain and standardized packaging. Plain packaging, a key measure to protect youth and curb the package as a means of promotion, has already been adopted by eight countries.

Increasing tobacco taxes is the most effective strategy to reduce tobacco use, especially among youth who have less disposable income. They're more price sensitive. That tobacco taxes decrease consumption is recognized by the World Bank, the World Health Organization, a vast number of studies in Canada and worldwide, provincial and territorial governments across Canada, and successive federal governments. Tobacco tax increases are a win-win, benefiting both public health and public revenue. The budget projects increased revenue of $375 million in this fiscal year alone as a result of the tobacco tax changes.

Inflation indexing of the tobacco tax was initiated in the 2014 federal budget, with indexing to occur every five years. The first inflation adjustment was to have occurred in 2019. Indexation ensures that tobacco tax rates are in effect kept the same on an after-inflation basis. In its pre-budget submission, Imperial Tobacco Canada recommended annual indexation instead of every five years as part of its recommendations to this committee.

Federal tobacco taxes are better than provincial tobacco taxes from a contraband perspective, because they apply on reserves. There's no difference between on-reserve and off-reserve tax rates. The level of contraband on which federal tobacco taxes are not paid is far lower than the contraband level on which provincial tobacco taxes are not paid.

I would invite committee members to turn to the background material that was circulated to you. The first graph shows comparative provincial and territorial tobacco tax rates. We see that Ontario and Quebec have the lowest tax rates in Canada but the highest contraband. That's counterintuitive to what we hear from the tobacco industry. They say higher tobacco taxes increase contraband. We see that in western Canada they have far higher rates of tobacco taxes but much lower levels of contraband.

Why is contraband higher in Ontario and Quebec? It's proximity to the illegal factories and sources of supply, but we can see that higher tobacco taxes have been sustained in the west and the Atlantic.

The next graph shows the trend in federal and provincial tobacco tax revenue. We see that even with reduced smoking rates, tobacco tax revenue continues to increase despite the lower smoking prevalence. In fiscal year 2017, the amount of $8.4 billion was collected, with even more of an increase if GST, HST, and PST on tobacco products were factored in.

The next graph shows the long-term trend in smoking prevalence in Canada. In 1965 it was 50% for Canadians aged 15 plus. In 2016 that was down to 17%. Over recent years we've seen a continuing decline. That's very positive, but it's also relevant when we see that tobacco tax revenue continues to increase. So tobacco taxes do benefit public revenue.

The next graph shows trends among teenagers, the 15- to 19-year-olds. We see a continuing decline in smoking prevalence among youth. That's very good. Tobacco taxes and other measures have contributed to that, but we want to keep driving this down further. The recently announced measures will help do that.

We thank the federal government for the new tobacco control measures that have been brought forward, and we appreciate the support from all parties. We look forward to continuing progress.

Thank you.

● (1550)

The Chair: Thanks very much, Rob.

We will now hear from the Canadian Child Care Federation and Mr. Giesbrecht, CEO.

Welcome, Don.

Mr. Don Giesbrecht (Chief Executive Officer, Canadian Child Care Federation): Good afternoon, and thank you very much.

I want to thank you on behalf of the Canadian Child Care Federation and Canada's child care and early learning sector for the opportunity to present today to all of you on part 1 of Bill C-74, specific to the measures noted with regard to the Canada child benefit.

Bill C-74, among its many items, calls specifically for new measures to be taken by the Government of Canada to index the Canada child benefit, or CCB, as of July 2018 to ensure it keeps up with the rising cost of living. This income supplement initiative, much like the CCB itself, is a progressive policy to lighten the financial burden on Canadian families, especially middle-class and low-income families, helping to support the costs of raising children. Like other federal income programs, such as the Canada pension plan, indexing CCB payments makes good sense and would be welcomed by eligible families.

Additionally, we support measures that ensure that appropriate taxpayers are eligible for the CCB and that information related to it can be shared with provinces and territories for certain purposes. As with indexing the CCB, this makes good sense and will help to ensure that those who are eligible will receive their benefit and any others that they may be provided by provinces, municipalities, or territories.

As an income supplement, the CCB is a welcome and important support for eligible families. The other integral federal support for Canada's families, which the CCB is not, is the federal government's multilateral framework agreement on early learning and child care, along with the companion bilateral agreements with the provinces and territories. Related to this, we are still waiting for the multilateral agreement on early learning and child care with indigenous communities to be formally signed, which will add another historic agreement, this one directly supporting Canada's indigenous children and families.

These agreements and frameworks are critically important, as they directly support the other part of Canadian family life, that being the need for high-quality, affordable, inclusive, and accessible child care, and just as importantly, start to address the national child care crisis in Canada. The Government of Canada has committed $7.5 billion over 10 years, starting in the last fiscal year, to fund these agreements, but significantly more investment is needed to bring Canada to the OECD benchmark of 1% of GDP annually.

Quality child care is the key element for economic security for the vast majority of Canadian families and for Canada's economy as a whole. While the CCB directly and financially supports families, it does not replace the need for progressive and significant investment in policy in child care systems and does not directly address child care affordability and accessibility.

A recent report by the Canadian Centre for Policy Alternatives on the rising cost of child care across Canada found that the typical family with young children spends about a third of its income on fees. To put this into perspective, child care fees can cost up to $15,000 a year in Ontario and even more in the GTA, more than triple the average tuition cost to put another child through university for one year, a system that is more significantly supply-side funded.

Supply-side funding, therefore, is how Canada—its provinces, territories, and indigenous communities—should be approaching child care affordability, policy, and funding, and exactly how we are seeing the provinces of Ontario and B.C. moving forward with their significant and historic child care announcements made this year, addressing head-on the crippling cost of child care in their respective provinces. They will join Quebec and P.E.I. in moving past tinkering on the edges of policy into a holistic and comprehensive solution for children and families.

In his ministerial e-newsletter sent out on April 24, 2018, the Minister of Families, Children and Social Development, the Hon. Jean-Yves Duclos, stated:

> For many parents, accessing quality child care is a major challenge. In fact, only one in four Canadian children has access to a regulated child care space. The development of Canada's early learning and child care systems is one of the best investments our government can make to help strengthen Canada's society and economy, and give children the best possible start in life.

We agree with the minister, and it is through direct funding from the federal government, along with policy, leadership, and partnership with provinces, territories, and indigenous communities, that Canada's child care crisis will be addressed. These things taken together with income support initiatives like the CCB will mean that Canada can join other OECD nations as a leader rather than a laggard with regard to investing in children and families.

I thank you for your time.

● (1555)

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

Next, from the Institute of Fiscal Studies and Democracy at the University of Ottawa, is Mr. Bartlett, Chief Economist.

Welcome.

Mr. Randall Bartlett (Chief Economist, Institute of Fiscal Studies and Democracy, University of Ottawa): Good afternoon Chair, Vice-Chair, and committee members. Thank you for inviting me to speak today as part of the study of Bill C-74.

As requested, I will focus my remarks on part 1 of Bill C-74, more particularly on the section pertaining to the small business tax rate and dividend tax credit, as well as the small business deduction based on passive income and on preventing income sprinkling.

While discussing the specific tax measures included in the budget, I would like to touch on some commonly cited concepts used when evaluating tax policy. These include the principles of fairness, efficiency, and administrability.

According to Kevin Page, former Parliamentary Budget Officer and president of the Institute of Fiscal Studies and Democracy at the University of Ottawa, in a recent article in *Policy* entitled “Cutting Taxes is Easy, Tax Reform is Hard”:

> Tax theorists typically talk about two fairness concepts. One is vertical equity, usually taken to mean the more you earn, the more you pay. Two is horizontal equity, meaning those in similar circumstances pay a similar amount. The Liberals were effectively making the case that potential base-broadening reforms to small business taxation were 'two birds with one stone'.

Indeed, the proposed small business tax changes, while unpopular among those who will see their tax bills rise, increase the fairness of the tax system from a tax theory perspective. The efficiency of a tax system speaks to the ability to generate tax revenue in a manner that is least distortive to incentives and behaviours, thereby having the least impact on economic activity.

Looking to the small business tax regime specifically, a 2015 study from the C.D. Howe Institute by Benjamin Dachis and John Lester, entitled “Small Business Preferences as a Barrier to Growth: Not so Tall After All”, looked at two federal programs intended to provide special support to small business: the small business deduction, and the scientific research and experimental development investment tax credit. To quote the authors:

> The purpose of these programs is to improve overall economic performance by mitigating inefficiencies in the market. However, since receiving benefits is conditional on staying small, these programs could act as a barrier to growth.

Further, the authors found that neither of these programs have a meaningful impact on boosting investment. Meanwhile:

> ...supports for small business have a social cost. The largest cost arises from the fact that the government must recoup forgone tax revenue by cutting spending or imposing higher taxes elsewhere. ...A more effective way of spurring economic growth is to reduce corporate income tax rates for all firms rather than providing preferential tax rates for small businesses.

The inefficiency of the tax system created by the small business tax regime goes further. Specifically, the rules governing private corporations as they currently exist allow for income to be moved between personal and business income, thereby creating an opportunity for tax avoidance. Indeed, the current rules incent taxpayers to structure their businesses to report income in a manner that is advantageous to them, but isn't the intent of the tax policy per se, with lower tax revenue being collected as a result.

This brings us to the ability of the federal government to administer its tax system in the spirit in which the tax legislation is written. This is difficult at times, as the letter and spirit of tax legislation are not always one and the same. Closing this gap requires, at times, changes to tax law.

In the context of changes to small business tax rules, these changes were first telegraphed by the federal Liberal Party in its 2015 election platform. Then, in July 2017, the Minister of Finance began his consultations on tax planning using private corporations. While the federal government should be commended for engaging in public consultations, I'm sure no one in this room has any illusions about how this rolled out. It didn't go well.

Just because people get mad about the fact that tax preferences will no longer be available to them doesn't mean the baby should be thrown out with the bathwater. While there were definitely areas for improvement in the proposed changes to small business tax rules, there was also a great deal of misinformation. In the end, from the fall economic statement 2017 through to budget 2018, the federal government rolled out the tax changes with adjustments having been made to address some of the concerns raised in the consultation process. While some stakeholders remain unhappy, tax practitioners I've spoken with seem to be of the opinion that a lot of the most glaring concerns have been addressed.

In closing, the tax rules governing private corporations were known to have been unfair and inefficient, as defined by economists, while making administration challenging. The changes that have been implemented are intended to correct this. Only time will tell if this was actually the case and if business investment is impacted as a result. That said, a better approach would have been to include these changes as part of a broader tax reform package, which could have broadened the tax base while, at the same time, lowering the average tax bill for Canadian households and businesses.

Thank you.

● (1600)

The Chair: Thank you very much.

Turning to MNP LLP, we have Kim Drever. Welcome.

Ms. Jennifer Kim Drever (Regional Tax Leader, MNP LLP): Chair and members of the committee, I would like to thank you for inviting us to speak with you today.

MNP believes that we need comprehensive tax reform. Without it, we will have an increasingly complex and costly tax system. We need simplification and modernization of the current system.

At MNP, we represent over 150,000 private businesses in Canada, including 16,000 farms. We are the country's tax experts on small business. No one in Canada works with more small businesses day in and day out than MNP.

First, I would like to commend the government for listening to the concerns raised by the community relating to the private company tax proposals. The draft legislation released on December 13 relating to the tax on split income—or, as we call it, TOSI—and the passive income proposals in the budget of 2018 have addressed many of the concerns that we had last summer and fall. However, we believe that there still needs to be further clarity.

Given the amount of time we have today, I would like to focus on TOSI.

First, it unfairly targets service businesses. They account for 78% of Canadian small businesses, and they are being specifically excluded from some of the rules.

There is a new 20-hour test, which would exclude people from having TOSI apply to them. Most family-run businesses have never kept time sheets. They have never really kept track of the hours that are being put in by the owners of the business. We question how CRA will ever be able to have the evidence they need for these audits. It will all be personal testimony. This legislation could be retroactive in nature, because Canadians will be penalized for not keeping records that they did not have to keep at the time the work was being performed.

Next is the test of reasonability. These TOSI rules introduce several new factors to the reasonability tests. Labour is one of the factors that we see elsewhere in the Income Tax Act with a reasonability concept, but this new reasonability test blurs the line between investment, the return on investment, and the labour. This is new ground. We are asking for a balanced approach whereby the Department of Finance and the CRA provide a comprehensive framework to help determine what is reasonable and what is not. This will allow Canadians and the CRA to apply the framework consistently.

I would like to introduce you to a sample client.

Bob and Karen have a company: BK Transport. This is a very typical client that you would see across Canada. Over the last 30 years, they have grown from a small trucking business to one with significant capital. They have over 250 employees and operate in three different provinces. Karen is ill. She has reduced her regular duties in the business and is rarely able to come into work. Like many entrepreneurs, Bob and Karen declared dividends instead of paying themselves wages throughout the last 30 years. No one needed time sheets; no one prepared time sheets. Now, due to the TOSI changes, when we are paying out dividends, we will need to determine the relative value of Bob's work in the business to Karen's work in the business.

The first thing we need to look at is whether TOSI even applies. Because they are both involved in the business and both are shareholders in the business, TOSI will apply unless we meet one of the specific exclusions. For Bob, he'll have to start tracking his hours. He's going to need to meet that test of 20 hours a week on average. He'll have to start tracking it and keeping time sheets. Karen won't meet this test, and the other thing is that Karen has never had time sheets in the past.

Next, BK Transport is a service business. It is in trucking, which is a service. This will not meet the specific carve-outs. When we explain this to Bob and Karen, they can't understand why their trucking business is impacted, but a business that is in retail or in construction, with the same number of employees and the same amount of capital, is fine. Their service business is not.

Under this draft legislation, the final way out is that of meeting the reasonability test. This is very subjective. Do we think her dividends would be reasonable? We would think so. Do we have certainty that the CRA would agree? There is no certainty here.

● (1605)

What they would benefit from would be more administrative guidance on what would be considered reasonable as well as clarity on the intended businesses to be caught. We believe catching businesses like BK Transport is an unintended consequence in the drafting of the legislation.

As far as passive income is concerned, the draft legislation is greatly improved from what was in the July paper. We recognize the government's commitment to finding an acceptable balance on this issue. In our written submission, we have three comments on these proposals for your consideration.

In closing, Bill C-74 is a considerable improvement over what we saw in July. That said, we still need more simplification of TOSI so that it's something that business owners can understand and actually comply with.

Please consider our three recommendations. First, we believe strongly in comprehensive tax reform. This should be for all taxes, not just income taxes. Second, because the new TOSI rules unfairly target service businesses, we think we should look at this again and see whether service businesses should be excluded. Last, we are very encouraged by the continued collaboration with all stakeholders and also the experts.

As we move forward to ensure that we have a fair tax system for all Canadians, we will have to keep doing this. I look forward to the committee's questions on the tax on split income, on the passive income proposals, and on the new RDTOH regime.

Thank you.

The Chair: Thank you very much, Kim, and thank you to all the witnesses, for your presentations. Who do we have on the list to start with?

Mr. Sorbara.

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

Welcome, everyone. It's nice to see some familiar faces again. I wish to start with Mr. Bartlett from the Institute of Fiscal Studies and Democracy. You made a comment regarding taxes and a preference to have lower taxes, if that is correct. I think you mentioned that in your comments. I want to put on the record that when we came in we cut taxes for the middle class. If you look over a five-year horizon, it's over $20 billion in tax relief to nine million Canadians. We did institute that.

We also increased taxes on those who can afford it, the wealthiest, the 1%, and this has been applauded in a lot of quarters. Then we also cut business taxes for small businesses. If you look at that over a four-year period, it's $3 billion that will be saved by small businesses, which we know are the backbone of our economy. In the city that I have the privilege of representing, as one of three MPs, there are over 13,000 private businesses and it'll be approximately a $3-billion tax cut, which I think will be beneficial to those folks. I did want to put that on the record, and I'm not going to ask you a question directly.

I want to go to Jennifer Drever at MNP. I read your brief and I wish to say thank you for your comment when you say you "applaud the progress that the Government has made to date which clearly demonstrates that when the Government and stakeholders work together, we can achieve results that benefit everyone."

I'm not going to go into TOSI, because the tax on splitting income will be a very interesting subject to talk about in a minute or two, and it's difficult. I do want to talk about passive investments and I would like to hear your comments on that, because I think we've landed at a place on passive investments that is equitable, that is fair, and that takes into account people's ability to save. If you want to go on maternity leave, you can save for that. If you're a doctor and you want to set aside up to $3 million or the equivalent in passive investments, $150,000 in income, all that's going to happen is that you're going to be bumped up from a 12% small business tax rate to the corporate tax rate of around 25% or 26%, which is not that bad on passive income, as opposed to active income.

Generally, the largest corporations don't pay the small business tax rate; that's to say, the wealthiest people don't pay the small business tax rate, because they're already in the higher corporate tax rate. So those entrepreneurs out there are going to keep doing what they're doing. I'm not asking for verification, but in your judgment, is that a fair assessment?

● (1610)

Ms. Jennifer Kim Drever: I would agree that it's a fair assessment. Overall, we were pleasantly surprised when we saw the budget.

There are three aspects of the passive income that I think we should look at. First, because the budget was announced on February 27, there were transactions that may have happened between January and February, such as disposing of large portfolios or doing things like that, that created capital gains. That activity pre-budget will impact the ability to get a small business reduction in 2019. There is a bit of a timing issue in the implementation of that.

The second issue is whether $50,000 is the right number to start the lower threshold. Some would say it is not quite high enough. The last issue with the passive income is the interplay with the RDTOH regime. It carries with it a lot of complexity. This is going to be difficult to administer. It is going to be difficult for accounting firms and especially small businesses that don't have very advanced advisers.

Mr. Francesco Sorbara: I'll go to Mr. Macdonald from the Canadian Centre for Policy Alternatives.

You commented on our budget being a gender-focused budget. We've had estimates from RBC, which I think was one, that if we could get the labour force participation of women up to near equal where men are, it's another $150 billion to our economy. We have about a $2 trillion economy, so it's something significant. I want to hear your take on that measure, and also on the CCB and how important that is for Canadian families.

Mr. David Macdonald: I think the Canada child benefit, as I've said before, will be important. Once we get the full dataset, which will probably be released some time next year, we'll see a fairly substantial decrease, particularly in child poverty, as well as in the poverty rates for the parents of those children. Of course, we often focus exclusively on child poverty, but poverty is a family concept, so if the children are lifted out of poverty, so are are the parents.

From a poverty reduction standpoint, the Canada child benefit is an important part of the overall basic income project that in essence the federal government has embarked on. Although, I would certainly encourage this panel to examine supports for, as I said in my presentation, families who don't have children and are not yet seniors but are still in low-income categories.

I think the Canada child benefit is unlikely to affect the cost of child care, which I would say is the largest impediment in Canada at this point in most of the provinces for female labour force participation. That is something the Governor of the Bank of Canada has highlighted, and others like Minister Duclos have highlighted.

As Don mentioned earlier, the multilateral framework does provide some funding. It's the first time that the federal government has been involved in child care funding for a decade and a bit. It's positive, although most of that will be targeted to lower-income families.

I think that if we're interested in higher female labour force participation, what we need is a country-wide program that sets fees across the country, not just in Quebec, Prince Edward Island, and Manitoba where there are presently set fees. Those lower fees I think will help with female labour force participation.

Mr. Francesco Sorbara: In terms of the way that the provinces have responsibilities and the federal government has responsibilities, for the first time, we have agreements with the provinces on the child care framework.

Yesterday we came to a $4-billion agreement on a national housing strategy with Ontario. We are, as a government, making great progress, versus if you look back to what I would reference as a “lost decade” under another government—not to be too political, but I needed to say that.

Mr. Russell, can you comment?

Mr. Ian Russell: Mr. Sorbara, I have just two very brief comments. I think you made some very good points.

You made the case that the passive income threshold of $50,000 translates to financial assets of about $3 million a year, and whether that was adequate or not adequate. I think we can debate that a bit, but it's certainly in the right direction.

There are two elements, though, that I think the committee should consider. One of them is indexation. It may be that $3 million dollars is appropriate in terms of a retirement portfolio for a professional, but I think there should be some protection for inflation, so that it keeps them at that lower rate.

The other is the retroactivity point, which the government in fact committed to before the proposals. The reason I think it might be important that retroactivity be taken into account, in other words that these proposals not be retroactive, is that professionals.... I'm thinking of some of the debate in the newspapers where doctors were encouraged to move into an incorporation strategy as some kind of compensation for salary, and the financial contracts that the medical profession negotiated.

It's those two elements, and I think my colleague from MNP made a good point about the complexities, which is another issue. I just wanted to make those two points.

● (1615)

Mr. Francesco Sorbara: Thank you, Mr. Russell. It's always welcome.

The Chair: I thank you all.

Mr. Kmiec, you have seven minutes

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

To some of you, welcome back to the committee. Ms. Drever, you were here last time.

I think it was almost a year ago now when the small business tax debacle started. In fact, an eloquent Liberal MP called it “God awful” in his communication. He's an MP I like to quote quite often. He's not listening, but that's okay.

Ms. Drever, you said that these proposals are far better than what you originally.... You said you were pleasantly surprised. I guess the impression in the accounting community more broadly was that the government was fully intent on going through with every single part of it.

I want to start with TOSI rules. The example you gave was a complexity involved in trying to prove that a spouse in a relationship is actually involved, or perhaps was involved in the past, in a business, but isn't involved today because of health reasons or they have moved on to other things. I heard the same thing when I was in Vaughan from a medical company. They are going to be changing the structure of their company and creating a new one in order to avoid some of the problems with these rules.

Are you hearing that from some of your clients, that they are going to be creating new companies in order to try to manage their tax burden?

Ms. Jennifer Kim Drever: We're not so much on that issue, but embedded right in the legislation is the ability to restructure to meet the requirements by December 31, 2018, which does allow for restructuring to happen so that shares would not have TOSI apply in certain circumstances. These complexities are really one reason that we do need comprehensive tax reform in this country. We need to ensure that we have predictability, certainty, and fairness that will drive the behaviours and that will drive the economy in the way we are looking for. Currently we don't have predictability and certainty with a lot of aspects of the Income Tax Act, and that's one thing that we as a firm would like to see.

Mr. Tom Kmiec: I fully agree with that. I'm not a tax professional or a lawyer, but I think it's high time. What I've heard from my constituents is that there's an expectation and that there needs to be a complete review of the way the tax system works and also probably a review of the people who are responsible for managing it and the quality of service given by CRA.

On your third point on page 6, in your view, the pooling of the refundable dividend tax on hand, or RDTOH, sources is going to be highly complex. This is an area where I struggle sometimes to understand this pooling effect and how you will comply and demonstrate to CRA where the different funds are coming from and how you're using it. Can you please take some time just to explain this pooling and the complexity involved in it?

Ms. Jennifer Kim Drever: That's actually a very good question. It will be difficult to determine whether this pooling is coming from dividends from eligible corporations, eligible dividends that are creating the part for tax that is refundable, or whether it is coming from other sources like capital gains. There's just going to be so much complexity and administrative burden in tracking this for clients all of the time.

RDTOH impacts a large number of businesses. They just have to sell an asset for more than they paid for it and they're going to be into this regime. So now whenever we have that, we are going to be pooling different things. We already have to pool different types of dividends. We're going to now have to pool different types of dividend refunds. It is a little bit of an administrative burden.

● (1620)

Mr. Tom Kmiec: Is your firm getting ready, on behalf of your clients, to take it to the tax court? Depending on the assessor you get, the auditor who looks at the file on the receiving end at CRA, the decision could be *a* or *b*, but the difference between the two might come very much down to the wire. You could really go either way and could require a judgment at some point to deem whether or not it is reasonable. Is your firm getting ready now for that potential case in which some of your clients will be forced to appeal their tax bills?

Ms. Jennifer Kim Drever: I think there are some reasonability issues elsewhere, but in this, for the most part, it's a purely mathematical question. There are formulas. It's just a matter of complying with the calculations and administering it and tracking it on a go-forward basis. I would be hard-pressed to determine what we actually would do, because we haven't even seen what the forms would look like or how the CRA would request that we track this.

Mr. Tom Kmiec: Mr. Bartlett, you mentioned that from an economic point of view—not political or anything else but economic —the best thing to do is to have a very broad base of taxation, and I'm paraphrasing here, with as few exceptions as possible to make it broad, easy to manage, and easy to apply so that there are no distortions in the system.

But we have a situation in which for the past almost 20 years, physicians especially—because I have a hospital in my riding and I have a lot of general practitioners and also a lot of clinics surrounding it—have been encouraged by their provincial body to professionally incorporate, and that's not unique to Alberta but is in many places. They are service businesses. There are very few people looking to buy into a practice like that, so they were encouraged by governments—provincial governments—to do so to take advantage of the tax structure. So what do we do for them?

What do you say to those who took advantage of a tax structure, because the provincial governments were telling them to do so and the federal government wasn't opposed to it, to doctors, to GPs, who are now finding themselves facing, in some cases, pretty high new taxes?

Mr. Randall Bartlett: I think in that case specifically, the tax system was sufficiently flawed in terms of how it was structured at the time and how it was laid out. I don't think we should perpetuate a system that's not particularly neutral because that is what happened in the past. I think what needs to be done is that any tax changes should be well telegraphed and gradually implemented so that individuals are able to change their business structure so as to not be immediately subject to significant and higher taxes. I think perpetuating a system that's broken is not necessarily the answer either.

Mr. Tom Kmiec: Can I ask you, then, about the concept of grandfathering? A lot of these people have made retirement decisions based on this model. I know a lot of guys who've done this. They have two or three kids at home. Sometimes their spouses gave up their careers so their wives could pursue their medical practices. Some of them were specialists in a clinic. That gentleman can't return to work very easily, but they've made retirement decisions as a couple, put in 20 or 25 years, and now the tax system is changing and some of them are being caught in this now. What do you say to them?

We often talk here about public sector workers and not changing their pensions on them, especially retirees living on a fixed income. What do you say to those people? Because what you're proposing— yes, we could telegraph to them, we have iPhones nowadays, we could probably do it faster, but they're still stuck in a situation where they're facing a whole bunch of new taxes, and they don't have a way out. There's no easy way to restructure their business.

Mr. Randall Bartlett: I think that speaks to the need for gradual implementation of tax changes, and that stakeholders are consulted in that process as well. I don't know the numbers on just how many businesses are part of this. What is, say, the level of passive income that's part of this? Do we continue to maintain a structure for businesses that exist today in perpetuity—not perpetuity, but for a long period of time so as to allow them to maintain the structure?

Say you have a young doctor today who has their business structured this way and isn't retiring for 20 years, are they grandfathered in because it's the existing tax structure today? I don't know if that's necessarily the intent of the previous tax legislation itself and whether or not that's going to be fair to someone who's entering the field a year from now. I think we need to make sure that it's gradual. We need to take stakeholders into account, but I don't think we should avoid reforming the tax system for the better overall.

● (1625)

The Chair: Thank you, all. We're well over.

Mr. Dusseault.

[*Translation*]

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

I would like to thank all of you for being with us today.

My first question is for Mr. Macdonald from the Canadian Centre for Policy Alternatives.

In February, the Minister of Finance made a budget statement, which dealt with pay equity. When you read Bill C-74, were you disappointed that there was no pay equity legislation.

[*English*]

Mr. David Macdonald: I think, broadly, the gender analysis of the budget was a positive move forward. The fact that the legislation on equal pay isn't out yet, I think hopefully it will come.

For instance when we look at some things like employment insurance not going all the way toward what we see in the Quebec-style model, that was a bit disappointing, but I think there was good movement there. There's certainly a lot more to be done. If anything, I think this budget was constrained by the electoral cycle, which I'm sure everyone's very much aware of. We might see some of the bigger proposals in next year's budget, which would be a pre-election budget.

[*Translation*]

Mr. Pierre-Luc Dusseault: We hope so.

I'll move on to another topic. You didn't mention it in your presentation, but did you analyze the new formula for the Canada pension plan? Does this formula take into account the years a person spent raising a child or years when a person with a disability did not work? The old plan excluded those years while the new plan provides for a drop-in mechanism. According to this mechanism, instead of excluding the years during which these people did not work, they are allocated an amount corresponding to the average of the previous five years.

Have you analyzed this matter? Several witnesses hadn't done a formal analysis to clearly determine that one formula is better than the other. Have you analyzed this matter from your side?

[*English*]

Mr. David Macdonald: It's an interesting question, and the fact that you would get a different drop-out provision for the CPP expansion versus the base CPP will almost certainly have some impact, particularly for those who are dropping out due to disability provisions, which only provides you with 70% of average income for the previous five years, as opposed to the child drop-out provision, which is 100% for the previous five years. It's not clear at this point what type of impact that will have. It will almost certainly have a gendered impact because it's more likely to be women who take those types of provisions than men, but at this point, it's not clear.

It seems that expediency, in getting the legislation passed as opposed to going back to the provinces and renegotiating it, was an impetus for changing the provisions as those weren't correctly ironed out in the first place, but we'll likely look at it over the summer and see whether there is an impact on people's retirement savings.

[*Translation*]

Mr. Pierre-Luc Dusseault: Is the drop-in amount part of the agreement with the provinces?

[*English*]

Mr. David Macdonald: Exactly. It appears that the averaging approach, as opposed to the drop-out provision, allowed the federal government to move forward with the legislation without having to go back to the provinces and renegotiate. Hopefully the impact is not particularly large. At this point, it's not entirely clear what the impact will be, but we're going to study that over the summer.

[*Translation*]

Mr. Pierre-Luc Dusseault: Okay.

I'm going to move on to another topic, corporate tax, as a number of witnesses have talked about it.

Just yesterday, a witness from Canadians for Tax Fairness said that in terms of passive income, $50,000 was too high a threshold. Today, we're hearing that this threshold may be too low. So I was wondering if some of you could comment on a $50,000 passive income. How much should the investment be to generate $50,000? Do you think that's an appropriate threshold?

I would like to hear from any of you having an opinion on that.

● (1630)

[*English*]

Ms. Jennifer Kim Drever: In the budget documents, they are using a 5% rate of return, which means $1 million of passive assets earning that $50,000 of passive income. I would agree that it probably is too low, the reason being that there are a lot of businesses that need passive assets in order to weather the economic storms. They need to save money so that when there's a downturn, they spend that money to keep their employees hired, to expand, or just to stay afloat, so $1 million of passive assets is probably not enough for a lot of those active businesses.

[*Translation*]

Mr. Pierre-Luc Dusseault: I'd like your opinion on another issue.

I am referring again to testimony yesterday from the vice-president of a chartered professional accounting firm, who said that an exemption for spouses could be interesting.

So I'm coming back to the issue of income distribution. He proposed that spouses be completely excluded from the income distribution rules. I'm wondering if any of you have any ideas on that or have figures on the number of companies involved. If spouses are excluded, to what extent would this reduce the number of businesses affected by these changes?

I don't know if any of you have an opinion on this.

[*English*]

Mr. Ian Russell: I think it would partly depend on the case.

In very small businesses, the spouse plays an integral role. There should be room in the legislation to allow for income splitting with the spouse, and for that matter, for other small-business related members or third parties to share in the income—in other words, participate in dividends. What it really turns on is the contribution of those entities into the business.

I think the legislation should have a flexibility to accommodate more than just the principal owner, and it should settle on a mechanism that is clear and simple for people to follow.

[*Translation*]

Mr. Pierre-Luc Dusseault: Okay.

[*English*]

The Chair: Do you have a quick one?

[*Translation*]

Mr. Pierre-Luc Dusseault: I was wondering if anyone else had an opinion. Perhaps Ms. Drever could give us hers on spousal exclusion in the issue of income distribution.

[*English*]

Ms. Jennifer Kim Drever: In the reasonability test, we have to look right now at the relative value of each of the spouses' work. It does make it difficult at times to put a value on what one spouse does versus another. If there was an exemption, it would remove that. We wouldn't have this concept of someone's work being less valuable in the business than another person's work because of what it is.

The Chair: Thank you.

Just before I turn to Mr. McLeod, I have a question on the comprehensive tax reform review that I think Ms. Drever mentioned. It's been mentioned before.

How would you see that taking place? Would it be with a royal commission, a group of experts, or what? This committee, in fact in our previous pre-budget consultations, recommended comprehensive tax reform, so I don't think you'll find much disagreement on this committee.

How would you put that together, if I can put it that way? How would you first start it? Eventually it'll get to a parliamentary committee, but what's the start?

That's for Ian or Kim, or both.

● (1635)

Ms. Jennifer Kim Drever: We do not think a royal commission is necessary, but we do think we should have a committee created—of stakeholders, of finance, of experts, and of parliamentarians—where they all work together to get a desired result. What we are looking for is predictability, certainty, and fairness. We don't know what would come out of this committee, but we do know that we need to look at taxation overall.

Right now in Canada, we have essentially a set of rules that was created back in 1972. The Canadian economy was completely different then. We had different types of businesses. We had different factors. Things change. Times change. Think of it like a tire: when we get a hole in the tire, we put a patch on it. Successive governments have done the same thing. We have patched that tire so many times that we're now patching the patches. There comes a time when we just need to get a new tire, and that's what we are proposing.

The Chair: I like that: “patching the patches”.

Ian.

Mr. Ian Russell: I guess I would start with the fact that it should be driven by the mandate. Then you would consider who would be involved. I think the mandate, to echo what Kim said, should be comprehensive and broadly based. It should deal with income. It should deal with expenditures. We're looking at the expenditure tax and at income taxes.

As was said, we have a patchwork quilt here that's 40 or 50 years old. I think the mandate should be broadly based. It should be objective in the sense that it could be a royal commission, but I don't think it necessarily has to be run by Parliament. In fact, I think it would be better if it weren't, but Parliament would feed into that process. It would seem to me that it would be critical, in order to execute the mandate, to have a cross-section of expertise from all aspects of the economy and the public.

I guess if you're looking at something to model it on, you could be looking at how reform took place in the U.S. recently. You could also look for ideas from the Carter commission back in 1972 and the Porter royal commission, which was on the financial structure in Canada as opposed to tax. I think there are some interesting models there.

I do commend the committee for going down that road, because I think ultimately that's what's needed in the country.

The Chair: David, go ahead.

Mr. David Macdonald: I certainly think that the panel of academics that was put together last fall to look at tax expenditures in particular was a good starting point. It's unfortunate that no public report came as a result of that.

Certainly, an in-depth examination of tax expenditures is a great starting point when it comes to tax reform—i.e., whether these tax expenditures are fulfilling the purpose they are supposedly fulfilling, who benefits from them, and what their implications are for horizontal and vertical inequality. That is to some degree examined, but I think it deserves much more fulsome examination. Frankly, many of those tax expenditures are much more unequal than the passive income and income sprinkling proposals that are incorporated in this budget, and they're worth a lot more.

The Chair: Okay. Thank you to all.

Mr. McLeod.

Mr. Michael McLeod (Northwest Territories, Lib.): Thank you, Mr. Chair, and thank you to all the presenters here today.

I'm especially happy to see the Canadian Cancer Society here, talking about some of the concerns we have around smoking. In our country, we still have large populations in different regions where there are a lot of smokers. Wherever there are a lot of smokers, there are high rates of lung cancer. In the Northwest Territories, Nunavut, Yukon, and all areas of the north, we still have a high number of smokers. I've raised the concern on the floor of the House of Commons about this issue and asked what can we do about it. We really have to get it under control. I've sat through presentations in my riding with people from health, with the charts on the wall. Smoking and lung cancer is double or triple what everything else is that is a cause of cancer.

It was interesting to hear that you are looking at the issue of raising the cost of cigarettes as a detriment to smoking. I'm not sure if I totally agree with that, so maybe you could explain it to me, because, as I said, I'm from the Northwest Territories where a carton of cigarettes is $161.20 today. I don't see anyone quitting smoking because of that. Maybe you could just tell me what information you have, what research shows that this works.

● (1640)

Mr. Rob Cunningham: There are extensive studies that show that higher prices decrease consumption. I think the prices in Northwest Territories vary by community. In some cases, they may be lower than that. Your health minister recently stated in the legislative assembly that he wants Northwest Territories to have the highest tobacco taxes in Canada. That used to be the case. Manitoba is the current leader. He's going to urge the minister of finance to try to ameliorate that.

Teenagers are especially price sensitive because they have less money, and they're not yet addicted, and it would go down more if we didn't have nicotine addiction. However, it clearly works, and we have seen some decrease in smoking among indigenous youth, especially off reserve, but it's still way too high. In Northwest Territories there is not the same lower tax rate on reserves that we see in provinces.

It is a tremendous concern. Had the tax rates not been there, smoking rates would be even higher.

Mr. Michael McLeod: I spent 12 years with the Government of Northwest Territories, in the capacity of cabinet minister, and I think every budget we increased the prices of cigarettes. I'm not sure if it's really doing what we intended it to do. I still live in a small aboriginal community. I'm probably one of the few MPs who does, and the smoking rates are still really high. Whatever we can do to lower that we should really work hard at it. I think the Government of Northwest Territories is also of the same mindset.

We had talked about plain packaging of cigarettes, and I thought it was a really good idea. I support it. However, we had people presenting as witnesses who were concerned about the issue of plain packaging because they felt it would drive people to start buying black market cigarettes, and that would probably make them easier to get. Anyone could get it, because the guys who are selling them don't care who they're selling to, whether it's children, teens, or adults. Do you think we should be concerned about that issue?

Mr. Rob Cunningham: No, plain packaging is extremely important. The tobacco industry argues that plain packaging will cause contraband, but they always make that argument. They did it for larger health warnings on packages. They made the argument for retail display bans. However, we have actually seen a decrease in contraband volumes. I can leave this with the committee. It is their own statements. It was much higher, for example, in 2009, with British American Tobacco and Philip Morris.

The Australian government was the first country to implement plain packaging. They said there has not been an increase in contraband. In fact there was a report by KPMG. They had to write a letter to the British health minister to disagree with how the tobacco industry was referring to KPMG's own report and they said that report could not be cited to say that plain packaging increased contraband in Australia.

In terms of counterfeiting, making it look like a package from the Australian market, they actually said they didn't find any counterfeit package intended to look like a package from Australia. There were some counterfeit Marlboros that looked like Marlboros from a different country, but they're obviously different.

The tobacco industry claims have not materialized in Australia.

Mr. Michael McLeod: My next set of questions is for the Canadian Child Care Federation. I and most of my constituents, I think, were very happy to see the increases in the Canada child benefit funding. It has gone a long way in helping the families and helping a lot of the communities that are facing challenges in being able to afford to raise their children.

You said that the agreement with indigenous governments was something you see as favourable, but do you think that we're going far enough in terms of child care benefits?

Mr. Don Giesbrecht: The Canada child benefit is certainly, as I said, very progressive, and it's certainly helping a very targeted population of Canadian families in supporting their day-to-day expenses, without a doubt.

The other piece of that, of course, is around the affordability of child care, and we have to be really careful not to confuse the two. The two are separate issues. Absolutely, the Canada child benefit helps to pay for, again, those day-to-day expenses, which, for the majority of Canadian families, include child care, but that does not solve the holistic and systemic issues of child care.

We are in a historic time where we have the federal government back at the table providing policy and financial leadership on the funding of child care specifically. We just need to do more of that.

● (1645)

Mr. Michael McLeod: I'm glad that you said that, because in my riding—and I've heard from other professionals also—they are suggesting that maybe we could go further. I represent communities, and I represent large aboriginal populations, and we are still plagued with many issues across the board.

Many people feel that we should be looking at putting in a program to help us deal with young women who are pregnant to provide help and advice through to the birth of their children with nutrition programs and early childhood programs. The reason for that is that we still have many, many issues that challenge our people. We have addictions. We have residential school fallout. We have trauma issues that don't allow for the best conditions for raising children in some of the communities, and there's a lot of despair in our communities, including suicide.

They're saying a long-term strategy that would help right from the time the young women become pregnant to when their children are three or four years old, a holistic approach, would be something that would serve us better, especially in indigenous communities.

Have you heard that?

Mr. Don Giesbrecht: Yes, absolutely. It's very interesting when you hear from other nations around this world that take that holistic view, where it starts with prenatal and goes on until your very last breath. Canada falls very short on a lot of those measures, so, without a doubt, looking at the well-being of mothers and of prenatal children, and then, obviously, of postnatal children, through a variety of services, community-based services—of the parents' choosing, which is also very important to this conversation—would be very welcome in this country, and I think it would benefit all communities.

The Chair: Thank you all.

Mr. Kmiec, we are on five-minute rounds.

Mr. Tom Kmiec: Thank you, Mr. Chair. I'm just going to split maybe two minutes of my time with Mr. Albas.

I want to go back to Ms. Drever on the TOSI rules. The rules use the term “business”, and the definition of “business” in the act is quite broad. It's very inclusive as a terminology, which means that you'll have to go back to the common law definition. If you get caught by these rules, these new rules, it's a very expensive tax bill.

In your view, your professional opinion, will you advise your clients to err on the side of caution, especially if they're a service company, as much as possible? It seems to me that one of the things the government should have done, especially in proposed subsection 248(1), is to provide a very clear definition of “business” that would clarify what business is for TOSI rules versus what is not business for TOSI rules.

Ms. Jennifer Kim Drever: That would be a great idea, or as part of comprehensive tax reform, we could deal with those kinds of issues. There is a lot of ambiguity in those TOSI rules as they are written around excluded shares, and there's also the question of why the service company is exempted. Why is there going to be TOSI on service companies, but there is not going to be TOSI if you own more than 10% votes and value for other industries?

It's going to impact a large portion of Canadian private business.

Mr. Tom Kmiec: You mentioned excluded shares, and I was going to go there next. The new version three rules proposed in this budget on TOSI are still hostile to multi-tiered corporate structures and trusts that hold shares of the corporation. The only reason I can see for doing that is to try to capture as many service companies as possible that may have a varying structure. Some farmers will be affected by this as well, pretty deeply, as they try to transition it to their kids. Is that the case, then?

● (1650)

Ms. Jennifer Kim Drever: With the test on excluded shares, you have to hold more than 10% of the votes and value directly, so shares held through a family trust would not meet the TOSI exceptions.

Yes, it would impact more businesses than just services, and then just PCs, but those businesses impacted have different structures in place, like the family trust, which are used for estate and succession planning purposes.

Mr. Tom Kmiec: Thank you.

I'll pass the rest of my time to Mr. Albas.

Mr. Dan Albas (Central Okanagan—Similkameen—Nicola, CPC): Thank you very much, first of all, Mr. Chair, for the floor, but also to our witnesses today. I'm going to continue to talk a bit about the passive income.

Ms. Drever, in regard to the passive income, I've met with real estate developers in my region of the Okanagan. Obviously they're quite concerned because they're being hit with a speculation tax provincially. At the same time, mortgage rules have come in over the last year or two coupled with passive investments. Oftentimes they will store their money in passive income holdings, waiting for the chance to build, because it can sometimes take two or three years for them to get approvals municipally.

Are we disincentivizing businesses from holding savings? Do you think that's a good thing? What are some of the other impacts we're going to have? To me it makes no sense that they get the small business deduction when they're building because they won't have savings.

Ms. Jennifer Kim Drever: The way this has been drafted does impact your small business deduction. One reason we did like this better than what we had discussed last fall and last summer was that we're not looking at a 73%-plus permanent tax rate on passive income anymore. That is a good thing that we're not looking at that.

With respect to the loss of the small business deduction in the years that you are waiting to build, that is the consequence of how it is drafted right now. As far as whether that is fair or not, that's something for the committee to decide.

Mr. Dan Albas: Do we want to encourage savings and investment? I guess some people might say, “We want to encourage certain types of investments and whatnot”, but to me the one-size-fits-all nature means that many people will find other ways and probably invest in other areas.

Ms. Jennifer Kim Drever: I would agree with that. The one-size-fits-all is less of a one-size-fits-all today than what we saw last October when we were discussing how these changes were going to be. The reason I say it is less than one-size-fits-all is that the small business deduction is a per-year deduction, so it might impact you one year and not another. That's going to your point, though, that there is a consequence for when you're saving money to hold....

I don't have a really good answer for you, unfortunately.

Mr. Dan Albas: Thank you.

The Chair: Thank you, Mr. Albas. It was good to end on such a good question too.

On this business of reasonability test, I think your example in here is a very valid one. I don't have the answer for this either. Sometimes the intent of the legislation and everything that Finance may intend to do isn't always interpreted the same way by CRA. I think all of us around this table have had experiences with that.

Can anything be done in terms of direction around a reasonability test or whatever to ensure that people who really shouldn't be caught in the loop are not?

Ms. Jennifer Kim Drever: We're not asking to get rid of the reasonability test. I want to be clear that we believe that reasonability tests exist to help complement the bright-line tests that are in the legislation. You do need it. We would like the CRA and Finance to work together on what they would consider to be reasonable. That would provide some certainty and clarity for taxpayers, for the Canadians this is impacting.

● (1655)

The Chair: The reasonability test is, I think, extremely important. I think you made a valid point there in terms of working together.

Did you want to come in, Ian?

Mr. Ian Russell: I just wanted to pick up on that comment. I think that, if you just leave it vague and rather open-ended, there's an uncertainty not only for the taxpayer or the tax-filer but also for the administrator of the tax system. This will take a long time to sort out, and the precedents will be probably set by CRA. I don't think that's the way you want to proceed with tax reform at all.

I think you want those who are writing policy, which is Finance, to be working closely with CRA, who's administering it, but putting as much detail and guidance as possible in those rules to, first of all, make it easier and efficient for the tax-filer, but second, to ensure fairness and objectivity. It seems to me that Finance ultimately should have that responsibility, so really they should go back to the drawing board and put a little more detail and rigour around it, certainly before the legislation becomes effective.

The Chair: Just so you know, and I'm sure you do, one of the difficulties for us when we're dealing with legislation, which the budget implementation act is, is that we can't really make recommendations. We're dealing with specific legislation. We can make recommendations on other issues and on pre-budget hearings, etc. I just don't know how we get around this one, but I do like the comments. We'll see what we can do.

Mr. Fergus.

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

I'd like to thank all the witnesses for coming here today.

I have a question I would like to pose to Ms. Drever and Mr. Macdonald, and hopefully I'll have enough time, Mr. Cunningham, to come back to you on a particular question.

The first question for Mr. Macdonald and Ms. Drever is in regard to what both of you feel. You raised a question in terms of how the government came up with the $50,000 passive income figure: What was it based on? I guess I'm just trying to get my head around perhaps the opposite, or if I could turn that question around a little bit, what would be the public good of a higher limit? Is it only of benefit to individuals? Does it promote economic growth? Does it promote savings among vulnerable people who would not otherwise save? I'm just trying to get my head around that.

Perhaps, Mr. Macdonald, you might want to start.

Mr. David Macdonald: There's a clear challenge, in that CRA and maybe the people who are using private corporations as a means of savings don't know in advance what they're going to do with that money. Maybe they will use the money to invest in their business and grow the Canadian economy, or maybe they'll use that money as a deferred RSP, which is not how it was intended.

The philosophical question is how you separate out the groups of people. People might be using that money for some productive purpose, or abusing the corporate structure as a means of retirement savings, for instance, or income sprinkling, or income sprinkling combined with passive income for their children's university education, for example.

I think one of the ways you can do that is that this distribution of passive income with this relatively high threshold of $50,000, or say roughly a million dollars in actual holdings in the corporation, eliminates the vast majority of private corporations, so there's a very small number of people who have this amount of money. Moreover, it's not that if you have a million and one dollars it's taken away by the government. You just pay a slightly higher tax rate. If you're saving for a couple of years for a new piece of equipment, or for a construction project, for instance, it's possible you might pay a higher savings rate, but again it's difficult to determine, nor is there any specific...whether it's $55,000 or $45,000.

I think the goal, hopefully, is to eliminate folks who are using private corporations as a means of retirement savings. I think that this obvious red line does that reasonably well but does not unduly punish people who are saving for a couple of extra years for actual investment.

● (1700)

Mr. Greg Fergus: Thank you.

Ms. Drever.

Ms. Jennifer Kim Drever: One thing you could look at is what percentage of that is on the overall value of the business, or the overall income of the business. If $50,000 is a small number in terms of that business, in theory maybe they don't get a small business deduction anyway, but it's something that might be looked at so it's not a one-size-fits-all at the low level.

I am from northern Alberta, and in the Peace country, where I live, we have a very highly oil- and gas-dominated market, as well as agriculture and different things such as that. There are a lot of business that had more than $1 million, let's say, of assets set aside before we had the last recession, in passive assets.

Mr. Greg Fergus: You mean income-producing passive investments, right?

Ms. Jennifer Kim Drever: Those businesses all survived, the ones that had money to stay afloat. Therefore, it comes down to whether it helps the public good. There are people who didn't lose their jobs because their employers kept them on. It comes down to issues with respect to whether $50,000 is the right number.

I agree that it's very tough to say. Is it $55,000, or what is the number?

Mr. Greg Fergus: Or $45,000.

Ms. Jennifer Kim Drever: Is it $45,000? What is the number?

Mr. Greg Fergus: Thank you very much.

I have just a very quick question.

Mr. Cunningham, thank you very much for your presentation and taking a look at the smoking rates. I was particularly taken with your analysis as to what the federal excise tax means in terms of places where there are higher numbers of contraband cigarettes.

At the very end, where you talk about the youth smoking rates based on age, has your organization disaggregated that data to look at what the smoking rate is among young women as opposed to young men, among 15- to 19-year-olds?

Mr. Rob Cunningham: Yes. It's going down among both boys and girls, so the news is good. It's also going down among young adults, both male and female. However, we need to keep at it.

Mr. Greg Fergus: Then there is no differential between the two.

Mr. Rob Cunningham: In recent years, there isn't. If we go back a couple of decades, there has been a change. It was going down among boys but not among girls. In more and more recent years, we've made progress among girls. It was very frustrating previously.

The Chair: Mr. Albas.

Mr. Dan Albas: I want to follow up on what was said earlier about the small business deduction and what level it should be. In your opinion, what should that level be?

Ms. Jennifer Kim Drever: I don't actually have an opinion on that. It is something that should get looked at as part of comprehensive tax reform. The answers will come out of the committee or the study.

Mr. Dan Albas: Okay.

With regard to the—

Please, Mr. Russell.

Mr. Ian Russell: It should be higher. As the previous questioner talked about in terms of whether it should be higher or lower, it seems that the $50,000 translates to about $1 million at a return of 5%. For a lot of people, if they're relying on that for retirement, $1 million is still a small number.

First of all, if the corporation is set up for an individual, the $50,000 per year would strike me as being on the low side. For a small business, even a business that qualifies for the small business tax deduction, we talked about oil and gas, but you could talk about agriculture. If you're buying capital equipment, it's quite expensive. In fact, $1 million in equipment is not an unusual number and it could be quite higher for a small business.

My point is that they should be looking at a higher number, and I'd like to know how they actually arrived at the number they ended up with.

Mr. Dan Albas: Should we also be looking at different categories of passive investments? For example, if I invest in a corporate bond that's going into productive enterprise, that's usually being used to capitalize new ventures, new factory expansion, and whatnot. There could be some discussion about whether, outside of an IPO, there is actually value being created for a stock, but to me, something seems to be wrong when we're saying that we're going to tax you higher because you've saved. Savings aren't like you planted it in your backyard or under your bed. It's actually still participating in the economy.

Mr. Russell, do you have any comment?

● (1705)

Mr. Ian Russell: Yes, I would say we haven't talked about the larger private businesses. To your point, though, I think the tax we end up with, on savings, as you put it, or passive investment, for taking that money out is quite punitive. It is a 75% rate. The argument is the tax deferral argument. I'm not sure that really balances, but what it does do is create a disincentive, and it's a disincentive for those companies affected.

Now Finance talks about the fact that there are only, I think, 2.7% of private companies affected by the rules. However, if you look at those companies—and the Parliamentary Budget Officer did look at those companies—there are a lot within that group. A third of them have capital over $15 million. We know there's about $250 billion in passive money out there, and 88% of that money, or virtually all of it, is going to be among those companies that are caught with the new rules. I think it then turns on the question of the role played by these companies, which are, in effect, carrying large amounts of passive income. If you look at the Parliamentary Budget Officer's analysis, he says that more than half of the companies in that category are either finance and insurance companies or companies managing other businesses, so they're holdcos or real estate.

Those companies that are caught in these rules are playing a very integral role in the small- and medium-sized business sector in Canada by providing financing, merchant banking, taking ownership positions in companies, and it seems to me, they're playing a very critical role in the capital formation process and helping small businesses. Again, we're talking a lot of capital, over $200 billion in capital, so what's going to happen as a consequence of this significant change in the effective tax rate on the dividends? Will these companies reduce that activity and do something else or will they migrate to the U.S. marketplace?

I think those are very legitimate questions to be asking, and I don't believe the analysis has really been carried out.

Mr. Dan Albas: I just want to switch gears here. When we talk about whether CRA can properly analyze a reasonable rate of return for a particular business, are we not setting a dynamic wherein one of two things will happen? People will say it's a grey zone and not take a legitimate deduction even though they are entitled to one, and instead they will just defer it or not take it. Worse than that, are we not creating a dynamic wherein CRA will have to collect loads more information for people who utilize the TOSI rules for their situation, resulting in more litigation? Again, in this situation, reasonableness is something that would be decided by a judge. I just don't think CRA has that expertise, nor does it have the time, by the sounds of it.

Would anyone like to comment on whether or not this is a dynamic we want to introduce in this legislation?

Ms. Jennifer Kim Drever: We do agree the reasonability is there to complement the bright-line test. We can't legislate every possible scenario, so we do need reasonability there as a last resort. We absolutely do, but I agree we are going to be relying on the courts to determine what is and what is not reasonable because that is a question for the judge.

Mr. Dan Albas: When I talk to small business owners, and they're given the idea, they usually ask, “What will it cost me to go to court? What will it cost me to tie this up?” Oftentimes, even though the entrepreneur may be very upset with the government because they don't think they should have to pay, they'll just do that. Are we not going to see more of those as well?

● (1710)

Ms. Jennifer Kim Drever: We would see that as well. It is a costly endeavour to go to court, and it is a costly endeavour to have the advisers to help somebody through this. There's probably a large number of businesses that won't even have the advice in the first place on what to do, so—

Mr. Dan Albas: They'll just leave it.

Ms. Jennifer Kim Drever: Yes.

The Chair: Ms. O'Connell, and then Mr. Dusseault.

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

Thank you all for being here.

Mr. Macdonald, you started off talking about the budget and the GBA+ analysis that was done for the first time, and I know you spoke to other things. It's been suggested, even by, for example, the Conservative critic for innovation, science and economic development, that this is really just pandering to gender and intersectionality.

Can you elaborate on why it's so important from an economic—not just moral—standpoint to do this type of analysis in budgeting?

Mr. David Macdonald: Given that it affects half the population, as you know, this is an important part of what governments do, and it's certainly not anything new that the federal government does gender analysis. I think what's new is that it has moved from the departmental level up into the public budget documents, which I think is a positive analysis, and it can highlight for us important ways that we can increase economic growth, potentially at relatively low cost.

As we were saying to an earlier question, the corollary to reduced child care fees, which is increased labour force participation, was one of the original reasons that Quebec reduced fees in that province. It began that process in the 1990s, and went from having one of the lowest female labour force participation rates to having one of the highest, above the Canadian average, In large part that's due to the fact that there are more spaces and those spaces are more affordable, and that allows women to work.

If that same approach were taken across the country, and not just in Quebec, Prince Edward Island, and Manitoba, where fees are set, there would be potentially substantial economic gains by helping families, and in particular, giving women who want to work the means to work, to raise their family incomes and spend that money back into the economy.

That's one example, but there are various other examples. EI is a good one, with the normalization of paternity leave. Through the “use it or lose it” paternal component, I think it will in the long run likely reduce the disparity between women and men who take time off for children—hopefully. It's a limited circumstance at this point, but I think it's an important step forward.

Ms. Jennifer O'Connell: Thank you.

In regard to your comments on the Canada workers benefit—and I appreciate that you acknowledged the changes and the impacts—you had some suggestions in terms of a way to potentially, especially in the future, make this program better. You mentioned that there was a gap for individuals between 50 to 65 years of age.

Do you have any ideas in terms of how to address this? Is it simply just opening it up to that age group, or do you think there needs to be something more targeted for this age range? You mentioned a variety of issues in terms of kids leaving, retirement, disability, and not quite kicking into CPP at that point.

Mr. David Macdonald: It's an interesting age group in the sense that federal and provincial supports are relatively strong for seniors, in particular. We have established basic incomes across the country of over $16,000 to $19,000, depending on the province, which is relatively high. The same is somewhat true for families with children, using the Canada child benefit as well as provincial top-ups.

But there exists one group of people—those who don't have children, who are not seniors, and who are not working and therefore cannot access the Canada workers benefit. Again, if you've worked hard all of your life and you've become injured, or your spouse has become injured and you can't work because you're caring for them, or you just can't work, there are essentially no supports, outside of social assistance.

There are a couple of approaches that we could take to try to better create transfers for that group. One is some sort of more universal top-up, which is something we've examined in our alternative budget, that would sit on top of the GST and be worth about $1,800, which would decrease fairly rapidly with income.

Another approach would be to decrease the age of eligibility for important programs such as the guaranteed income supplement and old age security, which currently start at age 65. For the bottom 20% of the population, they actually see their incomes rise substantially as they reach the age of 65, because they can access those programs. If those programs were available earlier, we would lower poverty rates, particularly for folks who can't work and have no other means of support outside of social assistance.

● (1715)

Ms. Jennifer O'Connell: Thank you. I appreciate that clarification.

Mr. Cunningham, we've heard before at this committee that dealing with contraband tobacco is certainly an issue, but there is sometimes a suggestion that this is what the government should really focus on and that plain packaging is not really necessary and won't have the desired impact of continuing to reduce smoking rates. We often have that debate, in terms of other jurisdictions that did plain packaging and whether or not it was successful.

I personally think that this is the right approach and the way we should be going, but can you elaborate on the point of why it's not one or the other, but plain packaging is the next step we need to move forward on?

Mr. Rob Cunningham: We need a comprehensive strategy that includes taxation, legislation, cessation programs, education, and contraband prevention. There is more that the Ontario, Quebec, and federal governments can do to reduce contraband. We support those measures in parallel. The convenience store associations that make this...they're funded by the tobacco industry. They have tobacco companies as members. They don't often volunteer that relationship.

The Chair: Mr. Dusseault.

[*Translation*]

Mr. Pierre-Luc Dusseault: Thank you, Mr. Chair.

I would like to dig a little deeper into the issue of passive income and try to get a figure that would show the importance of the small business deduction that would be lost by a $150,000 passive investment income.

Is there anyone, for example Ms. Drever, or others, who have done the math to determine the real monetary impact of this change? Do any of you have a typical example to tell us what the impact is? As a parliamentarian, I think it would be interesting to be able to put a number on it.

[*English*]

Ms. Jennifer Kim Drever: That will depend on the province that each business is in, but they start to lose the small business deduction at $50,000 of passive income. It's lost completely by the time they get to $150,000. They are losing it on a $5 for every $1 of passive income ratio.

The difference from a federal perspective is that we're talking about 6%, which is the loss of the small business deduction. That is what it's worth for small and medium-sized enterprises. Add on to that the provincial taxes and it might be about 16% for each dollar of income. If it's $5 of income that's being lost, we're looking at something like $60,000, potentially. That would be the value of the small business deduction that could be lost for these businesses.

Bear in mind that the small business deduction is a deferral, and when we have a small business deduction, the ultimate dividends come out as ineligible dividends and are taxed at a higher rate. If we pay a higher corporate tax rate and we don't have a small business deduction, the dividends come out as eligible dividends, and they're at a much lower rate. On a year-over-year, they end up being very similar. Effectively, if you were to withdraw all the money in the same year, it would end up being at very similar tax rates.

[*Translation*]

Mr. Pierre-Luc Dusseault: Thank you for that clarification.

My other question has to do with the reference to January 1, 2018. The bill proposes retroactively implementing measures related to the distribution of income. The average company concerned should be aware that, as of today, it is expected to have already begun to change the way it operates in order to comply with what is likely to be passed by Parliament by June and will therefore have a retroactive effect.

Does this worry you? Do you see this as a problem? Are you suggesting changing that date in the bill?

● (1720)

[*English*]

Ms. Jennifer Kim Drever: It would be a concern for many of the businesses, because they probably are not aware of how this will impact them. I would agree with that. There are a lot of small and medium-sized enterprises that do not know how these TOSI rules will apply to them and whether or not they are going to be subjected to them.

The revised legislation was released on December 13, and it was to be effective on January 1. That was very little time for most businesses to get ready for it. Should it be deferred? That would be a great idea. I don't know if that's an option.

[*Translation*]

Mr. Pierre-Luc Dusseault: Thank you.

[*English*]

The Chair: Does anybody else have other questions?

Do any of the witnesses have anything they want to add in conclusion? Just raise your hand and I'll catch you. Are we all done, all in? Okay.

Thank you very much for your testimony and for directly answering our questions.

The meeting is adjourned.