

## Testimony before the House of Commons Standing Committee on Finance

### **Bill C-74 – *An Act to implement certain provisions of the budget tabled in Parliament on February 27, 2018 and other measures***

**May 1, 2018**

Thank you, Mr. Chair, members of the Committee. As mentioned, my name is Ian Russell and I am President and CEO of the Investment Industry Association of Canada (IIAC).

Je vous suis reconnaissant de votre invitation à présenter, devant ce Standing Committee, les vues de l'IIAC / ACCVM sur la Loi d'Exécution du Budget de 2018. Je vais orienter mes remarques sur la première partie de ce Projet de Loi, et, plus particulièrement, sur les sections qui ont trait au revenu passif d'investissement, au remboursement des impôts sur les revenus des placements, et au saupoudrage des revenus.

Le point principal de nos remarques couvre l'impact des propositions d'imposition des entreprises privées sur le processus de formation du capital pour ce qui est des petites entreprises tout juste créées, ou au début de leur croissance. Des changements budgétaires récents sur les propositions d'imposition ont donné aux petites

entreprises qui peuvent prétendre à la déduction d'impôt en vertu de leur statut, une plus grande flexibilité et un champ plus étendu dans la gestion de leurs investissements financiers. Mais d'un autre côté, les entreprises privées ne sont toujours pas encouragées à construire des actifs financiers, et à s'engager dans le financement des besoins des petites entreprises et les activités de banque d'affaire.

Under the first feature of the tax proposals, the availability of the small business deduction, namely eligibility for a preferred corporate tax rate of 10% on the first \$500,000 of qualifying active income (falling to 9% effective January 2019), will be phased out for CCPCs and their associated corporations that exceed \$50,000 of passive investment income in the taxation year. This will be achieved by reducing the amount of income eligible for the small business rate by \$5 for every \$1 of investment income that exceeds the \$50,000 threshold. This phase-out mechanism eliminates the availability of the small business tax rate completely, once passive income reaches \$150,000 in a year. Businesses with more than \$150,000 in passive investment income will pay the higher general corporate income tax rate (15%) on their active business income.

While this approach is simpler than proposed previously, the inability to qualify for the preferred corporate tax rate, unless passive income is at or below \$50,000, unfairly penalizes small business owners by limiting holdings of passive investments to meet unforeseen contingencies, purchase corporate assets for eventual corporate acquisition or purchase of property to expand business operations.

Moreover, this tax proposal is unfairly retroactive in that past investments, and the income earned from such investments, is not grandfathered. The government had pledged in October 2017 that they would be.

The second feature limits the refundable taxes that private corporations receive on the payment 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 paid from passive income.

While the new proposals are an improvement, this new approach will increase the administrative burden for small business 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 of them. We have little idea how important these companies are to the Canadian economy. They may be among the largest and most dynamic in the country.

If the government does proceed, it should, at the very least, grandfather and exclude existing holdings of passive investments in determining eligibility for the small business deduction. Further, the sliding scale of permitted holdings of investment income, from \$50,000 to \$150,000, should be indexed to inflation.

Finally, the third feature of the proposals relates to the income splitting rules. The government should consider further amendments to the income splitting rules or, at a minimum, an implementation delay to provide greater clarity to the rules and give firms time to comply. Businesses will have to determine and define who has substantial ownership stake (10% or more) in the company. For professional businesses (like, lawyers and doctors) that derive their income from services, it becomes even more complicated. Moreover, the legislation leaves the definition of “services business” undefined.

Membres du Comité, les ajustements substantiels qui ont été faits aux propositions d'imposition des entreprises privées illustrent le fait que les nouvelles règles furent introduites trop rapidement, et sans analyse préalable suffisante. Si le gouvernement va de l'avant avec ces nouvelles règles d'imposition modifiées, nous lui recommandons de surveiller de près l'impact que cela aura sur l'expansion des entreprises privées actuellement en croissance, et la migration de leur business vers les Etats-Unis. Le Canada peut difficilement se permettre de perdre du capital disponible pour les petites et moyennes entreprises.

Thank you for your attention. I would be pleased to answer any questions you may have.

## Summary of IIAC Recommendations

That the federal government:

### Re: Passive Investment Income

- Not proceed with the passive investment tax proposals.
- If determined to proceed:
  - Grandfather past investments, and the income earned from such investments.
  - Index the \$50,000 and \$150,000 exemption limits to inflation.
  - Monitor the impact of the new rules on business behaviour.

### Re: Income Splitting

- Consider further amendments to the rules to provide greater clarity.
- Delay implementation to give businesses more time to prepare and comply with the new rules.