CANADIAN FEDERATION
OF INDEPENDENT BUSINESS
In business for your business™

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Small Businesses: the key to ensuring Canada's competitiveness

Recommendations

- Recommendation 1: That the government introduce a permanent measure to allow businesses to claim up to $100,000 per year spent on new equipment or technology, in the year of purchase.
- Recommendation 2: That the government implement a permanent lower EI rate for small business and/or introduce an EI holiday for hiring youth.
- Recommendation 3: That the government not include passive investments accumulated prior to 2019 in the formula for determining eligibility for the small business deduction.
- Recommendation 4: That the government delay the full implementation of the new TOSI rules until January 1, 2019 or later.
- Recommendation 5: That the government fully exempt spouses of small business owners from the new TOSI rules.
- Recommendation 6: That the government have a simple, comprehensive measure that goes beyond the current regulatory count and includes guidelines, policies and legislation.
- Recommendation 7: That the one-for-one rule be expanded to also apply to guidelines, policies and legislation.
- Recommendation 8: That the government continue to play a leadership role in reducing inter-provincial trade barriers.
- Recommendation 9: That the government implement a plan to balance the budget within the next three to five years.
- Recommendation 10: That the government ensure that intergenerational transfers of small businesses to family members are treated in a similar manner as those to a third party.

Introduction

An increasing number of regulatory requirements and rising taxes are weighing heavily on small- and medium-sized enterprises (SMEs) in Canada. Recent government policy decisions, such as the tax changes affecting private corporations, have not helped SME confidence. Coupled with uncertainties around Canada-U.S. relations, increases in payroll taxes, and the introduction of carbon taxes in many provinces, business owners are understandably nervous about what the future holds for them and their business. This lack of confidence is reflected in CFIB's latest Business Barometer® which dropped by five and a half points to 56.8 in July, the lowest it has been since the resource price crunch in 2015.[1]

While it may seem that the Canadian economy continues to grow at a reasonable pace, there are signs that it may be waning. As such, it is essential that the government act now, rather than later, to ensure that small businesses can remain competitive. The OECD reports that the entrepreneurship rate in Canada has been falling steadily since the 1980s and, as a result, business dynamism in Canada is weakening.[2] This is evidenced by the fact that almost half of small business owners said they would not advise their children to go into business due to the high costs of regulation.[3] Additionally, the recent tax cuts in the U.S. have had an impact on Canadian businesses' ability to stay competitive, leading some business owners to consider relocating their operations south of the border. In order to restore Canada's competitiveness, action must be taken to offset some of the growing costs being imposed on small businesses by governments.

Reducing the tax burden for small businesses

Rather than investing in new programs or grants aimed at boosting small business innovation and competitiveness, the government should instead focus on ensuring SMEs have the necessary capital available in their business. The second-highest barrier to innovation for SMEs is cost, tied with government red tape.[4] This is because access to financing remains more difficult and costly for smaller businesses as they are considered higher-risk than larger firms. As a result, they most often have to rely on their own business capital and profits to make investments in their business.[4]

The recent tax changes affecting private corporations, combined with new carbon taxes in many provinces and at least five years of Canada Pension Plan (CPP) increases starting in 2019, contribute to a growing tax burden on small businesses in Canada. While we welcome the government's commitment to reinstate the promised reductions of the small business corporate tax rate to 9%, these additional government-imposed costs will further limit small businesses' ability to reinvest their profits into growing their business. In reaction to the CPP increases alone, 69% of small business owners say they will feel more pressure to freeze or cut salaries, and 50% say they will be forced to reduce investments

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[1] CFIB, *Business Barometer*, 736 responses, July 2018.
[2] OECD, *Policies for Stronger and More Inclusive Growth in Canada*, July 2017.
[3] CFIB, *Regulation and Paperburden Survey,* 7,823 responses, September 2017.
[4] CFIB, *Beyond R&D: Supporting Small Business Innovation*, October 2016.

in their business.[5] To encourage new business investments and boost innovation, **we recommend the government allow businesses to claim up to $100,000 per year spent on new equipment or technology, in the year of purchase.** A similar measure was adopted in the U.S. under President Obama for small business purchases up to $500,000 and was increased as part of the most recent U.S. tax cuts to $1 million and expanded to large businesses. While it is temporary for larger firms, it is a permanent measure for American small business and should be made available to small businesses in Canada to help them remain competitive.

Thirty-seven percent of business owners said they may have to reduce the number of employees due to CPP increases.[6] At the same time, the shortage of skilled labour is the primary limitation keeping SMEs from increasing their productivity or growing their business.[7] With higher payroll taxes and minimum wage increases in several provinces, the government should look at ways to offset the increasing costs of labour. **We recommend the government implement a permanent lower EI rate for small business (such as on the first $500,000 in payroll). The government could also consider introducing an EI holiday for hiring youth, as promised in the Liberal Party's 2015 election platform.**

The new tax rules restricting passive investments and family income-splitting will mean that an estimated $1 billion will leave the pockets of small business owners and go into government revenues. Small business owners with previous passive investments have told us they often use these savings to reinvest in their business by buying new equipment or building to expand their operations. While the rules on passive investment income announced in the budget were simpler than the original proposals, some small business owners who already have passive investments in their business may be unfairly punished with higher corporate tax rates. As such, we urge the government to **grandfather passive investments accumulated prior to 2019, as was implied prior to the budget, so those businesses do not lose access to the small business deduction going forward.**

Business owners also need a predictable and stable tax environment where they feel confident making investments in their business. However, the new rules on the Tax on Split Income (TOSI) continue to create uncertainties for small business owners as they struggle to understand how the new rules will apply to them. Even if most small business owners will not pay more in taxes under TOSI, many of them will be forced to deal with more red tape in order to comply with the new rules. More time is needed, not only for the Canada Revenue Agency (CRA) to develop proper guidance materials, but also for small business owners and tax professionals to understand and adapt to the new rules. As such, **we recommend the government delay the full implementation of the new TOSI rules until January 1, 2019 or later.** Further to this, **the government must take steps to better recognize the realities of running a family business by exempting spouses from the new TOSI rules.** Spouses take on additional risks in addition to playing many formal and informal roles that are vital to operating and

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[5] CFIB, *Canada Pension Plan Expansion Survey*, 4,422 responses, June-October 2016.
[6] Ibid.
[7] CFIB, *Business Barometer*, 736 responses, July 2018.

growing a small business. Exempting spouses will also help lower the compliance burden on small business owners who employ family members.

Tackling excessive government regulations and paper burden

When small business owners are forced to spend time and money dealing with excessive and unnecessary government regulations, or bad customer service, they have fewer resources they can dedicate to growing their business. Sixty-one percent of business owners said excessive government regulations discourage them from growing their business and 68% say it significantly reduces their productivity.[8] CFIB has estimated that excessive and unnecessary red tape costs Canadian small business owners $10 billion every year.[9] As the United States has taken a drastic approach to reducing red tape for businesses, Canadian firms risk being left behind if the government does not do more to address the high costs of government regulations.

Currently, the impacts of measures, such as the one-for-one rule, are limited as they only apply to regulations and not guidelines, policies or legislation. In order to ensure efforts to reduce government red tape have a meaningful impact on small businesses, **the government must have a simple, comprehensive measure that goes beyond the existing inventory known as the administrative burden baseline count. Other jurisdictions, such as Manitoba, have found that most of their rules lie outside of regulations and so government must take steps to expand how it measures the regulatory burden by including rules found in guidelines, policies and legislation.** The most notable example is the *Income Tax Act*, which is one of the most burdensome pieces of legislation for SMEs, but is not included in the overall regulatory count or the one-for-one rule. As such, **the one-for-one rule must be similarly expanded to include other types of administrative burden found in policies, guidelines and legislation in order for the impact to be felt by small businesses on the ground.**

While the government looks for ways to encourage SMEs to export abroad, work must also be done at home to address trade barriers between the provinces. Internal trade barriers have a direct cost for small businesses, which are forced to comply with confusing and overlapping regulatory requirements in different jurisdictions. With ongoing trade issues with the United States causing significant worries for small business owners, it is important to ensure they have the opportunity to trade to other provinces and expand their market share within Canada. While the recent announcement by the Premiers to address certain inter-provincial red tape barriers is a step in the right direction, **the federal government must continue to play a leadership role on this file to ensure that these commitments are met by establishing clear deadlines to resolve all 23 issues within a year, as well as identify new barriers that must be addressed on an ongoing basis.**

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[8] CFIB, *The Cost of Government Regulation on Canadian Businesses*, January 2018.
[9] Ibid.

Addressing unsustainable debt and deficit levels

The federal deficit is now projected by the Parliamentary Budget Office (PBO) to be $22.1 billion in 2018–2019,[10] significantly higher than the $15.1 billion projected in the 2018 budget or the $10 billion promised by the government during the last election. As public debt charges are set to increase, more government revenues will be needed to service the growing debt, leaving less for essential programs and services. During a time when interest rates are also increasing, paying down the debt will cost even more. Although the economy is growing at a modest pace, the federal deficit should be addressed now, prior to any economic downtowns. Small business owners in particular worry that continued deficits and growing government debt levels will mean increases in their future tax bills. As such, **we urge the government to put forward a plan to balance the budget within the next three to five years.**

Helping the next generation of entrepreneurs

With an aging population, a greater number of business owners will be thinking of retirement in the next few years, and many will be looking to sell or transfer their business to the next generation of entrepreneurs. A recent CFIB survey found that almost half (47%) plan to exit their business within the next five years.[11] As small businesses are often family-run, many owners wish to keep the business in the family. In fact, 45% say they plan on selling or transferring their business to a family member.[12] However, under the current rules in the *Income Tax Act*, it remains more expensive to transfer a business to a family member than to a third party. When an individual sells their business to a family member, the difference between the sale price and the price originally paid is considered a dividend. If the individual sells the business to an unrelated person, it is considered a capital gain. As a result, these rules discourage the transfer of a business to a family member because the transaction does not include the right to a lifetime capital gains exemption and is, therefore, more heavily taxed.

In the 2018 budget, the government indicated that it would look into ways to address the ongoing issues with family succession. **We urge the government to find solutions to ensure that intergenerational transfers of small businesses to family members are treated in a similar manner as those to a third party while, at the same time, maintaining the integrity of the tax system.**

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[10] PBO, *Extended April 2018 Economic and Fiscal Outlook*, July 2018.
[11] CFIB, *Succession Planning for your Business Survey*, 2,507 responses, May 2018.
[12] Ibid.