HOUSE OF COMMONS

CANADA

STUDY ON SMALL BUSINESS TAX MEASURES: CANADA'S AGRICULTURAL COOPERATIVES

REPORT OF THE STANDING COMMITTEE ON FINANCE

Massimo Pacetti, Member of Parliament
Saint-Léonard / Saint-Michel
Chair

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Also available on the Parliamentary Internet Parlementaire: http://www.parl.gc.ca

Available from Communication Canada — Publishing, Ottawa, Canada K1A 0S9

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THE STANDING COMMITTEE ON FINANCE

has the honour to present its

FOURTH REPORT

In accordance with its mandate under Standing Order 108(2), your Committee has studied proposals on the Agricultural Cooperatives and has agreed to report the following:

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STUDY ON SMALL BUSINESS TAX MEASURES: CANADA'S AGRICULTURAL COOPERATIVES

In the spring of 2004, the House of Commons Standing Committee on Finance undertook a study of federal tax measures to assist small businesses in certain sectors, including agricultural cooperatives. The Committee met with the Coopérative fédérée de Québec in April 2004, and with the Coopérative fédérée de Québec, the Canadian Co-operative Association, the Agropur coopérative, the Société coopérative agricole de l'Îsle aux Grues, the Alberta Value Chain Cooperative Ltd, the Peace Country Tender Beef Co-op, the Co-op Atlantique, the Saskatchewan Wheat Pool, the AgriEst Centre Agricole Coop, the United Farmers of Alberta and the Conseil canadien de la Coopération in December 2004. During their December 2004 appearance, each witness spoke about its capitalization and other challenges from its own perspective. In May 2004, the Department of Finance commented on the testimony presented by the agricultural cooperative sector in April 2004.

This report briefly summarizes the main points made during presentations to the Committee by the Department of Finance and representatives of the agricultural cooperative sector, and contains recommendations that we believe — once implemented — would help Canada's agricultural cooperatives to overcome their capitalization challenges and thereby contribute to the growth and prosperity of our country.

A. The Proposal Made by the Agricultural Cooperatives

In its April 2004 appearance before the Committee, the Coopérative fédérée de Québec re-iterated a tax proposal that it had presented to the Committee during the 2003 pre-budget consultations. Describing Canada's agricultural cooperatives as "central to the development of this country's manufacturing industry," the Coopérative remarked that Canada's 1,300 agricultural cooperatives have 400,000 independent member-producers, employ more than 36,000 individuals and generate more than $19 billion in revenue annually; as well, they account for 15-20% of the Canadian farm procurement, farm processing and farm marketing sectors. In December 2004, we were informed that, according to a recent study conducted in Québec, the survival rate for cooperatives is almost double that for any other type of business. As well, agricultural cooperatives allow farmers to exert local control and to reinvest in the economic and employment opportunities within rural communities.

According to the Coopérative fédérée de Québec, cooperatives return tens of millions of dollars to their members and their communities each year; in rural communities, they may be the "last stopgap" available for active economic development. The Committee was also told, during the December 2004 appearance, that cooperatives are "a critical player in regional development in a world that is often described as a global village and where capital is in constant flow.” In the view of our witnesses, the Canadian agricultural cooperative sector requires tools to adjust to globalization and to ensure the sector’s sustainability.

Witnesses told the Committee that the cooperative sector has a significant market share in business activities that are usually dominated by corporations, including banking, insurance, retail food trade, pharmaceuticals and agriculture. As well, agricultural cooperatives are important internationally: more than one-third of global food production is under their control. We were also informed that agricultural cooperatives act in the economic interest of their members while also pursuing social and environmental objectives.

Regarding the capitalization challenges experienced by agricultural cooperatives, the Committee was told that the following factors are important:

- the cooperative’s primary mission and reason for being — such as smaller production units, maintaining local jobs, remaining as the town’s last service station/hardware store, etc. — are compromised if the cooperative is to be cost-effective;
- unlike privately-owned businesses, cooperative members hold share capital that does not appreciate, which limits their incentive to invest;
- cooperatives have little — if any — access to external sources of capital, especially venture capital, since venture capitalists typically expect their return on investment to be capital gains, rather than future dividends;
- capitalization sources are typically limited to undistributed benefits in the form of patronage dividends, new contributions from members, loans from financial institutions and perhaps limited access to venture capital, for example through Farm Credit Canada; and
- the aging agricultural population will mean that farmers will retire and may withdraw their share capital from the cooperatives in which they are members.

With these capitalization challenges, and recognizing globalization and increased competition, agricultural cooperatives are limited in the strategic investments that they can make in order to ensure their success and prosperity. Consequently, they are vulnerable to competition, which has implications for the rural communities in which they do business. The Committee was told about recent studies suggesting that public authorities should develop solutions to level the playing field between agricultural cooperatives and other businesses with respect to access to capital.

The Committee was told that, at present, the federal cooperative tax regime requires that all patronage dividends be included in the taxable income of the individual in the year of receipt, regardless of whether the payment is made in cash or in shares. Because of this tax treatment, some cooperative members are reluctant to receive dividends in the form of shares, since they must pay taxes on these shares in the current year, even though they will only realize a cash receipt for the shares sometime in the future. Increased globalization and competition, and pressures regarding food safety and environmental protection, are creating challenges for agricultural cooperatives, particularly with respect to an increased need for capitalization.

The "capitalization constraint" identified by the Coopérative fédérée de Québec in April 2004 and re-iterated in December 2004 was confirmed in a November 2002 report by Ernst & Young, *Canadian Agricultural Co-ops Capitalization Issues and Challenges: Strategies for the Future*, funded by the federal government. Elements of the Coopérative's proposal were identified in that report. Other reports have also commented on agricultural cooperatives, including the October 2002 report by the Prime Minister's Caucus Task Force on Future Opportunities in Farming, *Securing Agriculture's Future: Invest Today, Prosper Tomorrow*, and a May 2002 report by the Advisory Committee on Cooperatives, *The cooperative option: A natural fit for public policy in agriculture*.

In its appearances, the Coopérative fédérée de Québec has proposed:

- an income tax deferment for patronage dividends that producers wish to maintain in their cooperatives; and
- a Cooperative Investment Plan that would encourage cooperative members and workers to invest in their cooperatives.

A Cooperative Investment Plan could, for example, allow members and employees of a cooperative to deduct their investment up to a fixed percentage of their gross income.

In the view of the Coopérative fédérée de Québec, implementation of its proposal would allow Canadian agricultural cooperatives to address their capitalization needs, which — in turn — would enhance their ability to compete and allow them to continue to contribute to the economic and social development of the communities within which they operate. It would also recognize the fundamental role played by agricultural cooperatives in Canadian society, contribute to the well-being of rural communities, and acknowledge the importance of family farms to the Canadian agriculture and agri-food industry.

In the view of witnesses, implementation of the proposed Cooperative Investment Plan for agricultural cooperatives would involve a federal fiscal cost of $14-$20 million annually, depending on the structure of the Plan. This amount would, with its leveraging and complementarity effects, allow these cooperatives to invest several hundred million dollars in regional economies.

B. The Response by the Department of Finance

In its May 2004 appearance, the Department of Finance told the Committee that "[t]he co-operative sector has stated that the capitalization problems are not caused by tax." The sector is, however, making a proposal that would provide federal assistance through the tax system. In the Department's view, "[i]t may be more effective and transparent to consider other, non-tax measures … to address these issues." The Department noted that nine of the 13 recommendations made in the Ernst and Young report on the capitalization of cooperatives "were not of a tax nature;" for example, coordination of federal and provincial legislation to eliminate impediments to mergers by cooperatives was noted.

Moreover, the Department said that "the current tax treatment of patronage dividends is preferential when compared to regular dividends," and estimated that the federal cost of the tax deferral on patronage dividends would be $30 million in the first year and $100 million over five years. Regarding the proposal for a Cooperative Investment Plan, the Department remarked that "[p]roviding a tax credit for investments in co-operatives would provide a tax advantage to co-operatives that would not be available to other businesses. Large co-operatives might benefit more than small businesses."

C. The View of the Committee

In the Committee's view, it is important that all Canadian businesses — including cooperatives — operate on a level playing field and within a tax regime that enables them to meet their needs in order that they and the Canadian economy can grow and prosper.

The Committee realizes that Canada's agricultural cooperatives may be experiencing capitalization challenges that limit their contribution to the economic and social development of the communities — mostly rural — within which they operate. We are also reminded, however, of the comments made by the Department of Finance, which feels that the capitalization problems being experienced by Canada's agricultural cooperatives are not caused by the tax system, and that the proposed Cooperative Investment Plan might advantage cooperatives over other businesses and large cooperatives over smaller businesses. While the Department suggested that other non-tax measures might be considered, we believe that the proposal made by the agricultural cooperative sector should be implemented immediately and that other non-tax measures that would assist the sector in meeting its capitalization needs should also be considered. From this perspective, and hopeful that the recommendations made by us in our 2004 pre-budget report regarding access to capital might also be of some assistance, the Committee recommends that:

The federal government immediately take the following three actions:

- **allow an income tax deferment for patronage dividends that producers wish to maintain in their agricultural cooperatives;**
- **create a Cooperative Investment Plan that would encourage agricultural cooperative members and employees to invest in their agricultural cooperatives through allowing them to deduct their investment up to a fixed percentage of their gross income; and**
- **undertake a review of tax and non-tax measures that would enable the agricultural cooperative sector to meet its capitalization needs.**

APPENDIX A
LIST OF WITNESSES

Associations and Individuals	Date	Meeting
Agriest, Centre Agricole Coop Éric Dagenais, Director General	2004/12/02	28
Agropur, Coopérative Agro-Alimentaire Serge Riendeau, President		
Alberta Value Chain Cooperative Ltd Doug Borg, Project Coordinator		
Canadian Cooperative Association Jean-Yves Lord, Director General		
Conseil canadien de la coopération Michel Rouleau, Vice-President		
Co-op Atlantic Harvie John, CEO		
Coopérative fédérée de Québec Pierre Gauvreau, CEO Denis Richard, President		
Peace Country Tender Beef Co-op: Alberta Neil Peacock, President		
Saskatchewan Wheat Pool Fern Nielsen, Administrator		
Société coopérative agricole de l'Île aux Grues Simon Painchaud, President		
United Farmers of Alberta Dave Elliott, Treasurer		

REQUEST FOR GOVERNMENT RESPONSE

Pursuant to Standing Order 109, the Committee request that the Government table a comprehensive response to the report.

A copy of the relevant Minutes of Proceedings *(Meetings No. 28 and 35 including the present report)* is tabled.

Respectfully submitted,

Massimo Pacetti, Member of Parliament
Saint-Léonard / Saint-Michel
Chair

MINUTES OF PROCEEDINGS

Tuesday, December 14, 2004
(*Meeting No. 35*)

The Standing Committee on Finance met *in camera* at 11:10 a.m. this day, in Room 269 West Block, the Chair, Massimo Pacetti, presiding.

Members of the Committee present: Don H. Bell, Guy Côté, Charles Hubbard, John McKay, Maria Minna, Massimo Pacetti, Brian Pallister and Judy Wasylycia-Leis.

Acting Members present: Louis Plamondon for Yvan Loubier.

In attendance: *Parliamentary Information and Research Service*: June Dewetering, principal; Alexandre Laurin, analyst.

Pursuant to Standing Order 108(2), the Committee resumed its study on Small Business Tax Measures: The Cooperatives.

The Committee resumed consideration of a draft report.

At 11:11 a.m., the sitting was suspended.

At 11:23 a.m., the sitting resumed.

It was agreed, — That the draft report be adopted, as amended, as the Third Report of the Committee.

It was agreed, — That the Chair, analysts and clerks be authorized to make such typographical and editorial changes as may be necessary without changing the substance of the Report.

It was agreed, — That the Chair be instructed to present the Third Report of the Committee to the House.

At 11:50 a.m., the Committee adjourned to the call of the Chair.

Richard Dupuis
Clerk of the Committee