Edmonton Chamber of Commerce

2012 Pre-Budget Brief to the House of Commons Standing Committee on Finance

August 12, 2011

Executive Summary

On behalf of nearly 3000 business members, the Edmonton Chamber of Commerce is once again pleased to have the opportunity to provide you with our members' most important federal tax and program spending priorities related to the upcoming Federal Budget.

Like most Canadians the Edmonton Chamber of Commerce would like to see the Government of Canada stay the course with respect to targets and initiatives announced in last year's federal budget relating to deficit reductions and savings via program spending reviews. However, for the upcoming budget, our members have identified the following three tax initiatives as essentially cost-neutral recommendations that would improve business efficiency and profitability and help to ensure the continuation of job creating SMEs:

1. Introduce legislation requiring the timely assessment of income tax returns wherein taxpayer's returns are automatically deemed to be assessed as filed (and are duly processed) after 120 days of filing thereby initiating the statute barred period after which reassessment could be issued.

2. Undertake a comprehensive review of the tax provisions affecting estate and succession planning in the next 24 months to determine whether the existing tax regime appropriately considers transfer of family-owned businesses.

3. Establish an expert committee that includes key internal and external stakeholders to, within a 36 month period, undertake a comprehensive review of taxing statutes with the objective of indentifying, recommending and ensuring the implementation of ways and means to simplify tax legislation, reduce compliance costs and ensure all tax payers are treated fairly, and to continuously monitor changes and publicly report progress at least annually.

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On behalf of nearly 3000 business members, the Edmonton Chamber of Commerce is once again pleased to have the opportunity to provide you with our members' most important federal tax and program spending priorities related to the upcoming Federal Budget.

Addressing deficits effectively is essential to improving confidence and driving business investment —a precursor to sustainable economic growth. Chambers of commerce called on the federal government to balance its books by 2015 and to do so by limiting program spending growth to about 1.6 per cent per year, on average, through fiscal 2015-16. It was also recommended that savings could be realized by improving the efficiency and effectiveness of government programs. Close scrutiny of government programs must be an ongoing process.

It is also crucial that we do not undermine the progress that has been achieved to-date with respect to corporate and personal income tax reductions.

With respect to business taxes, the government must proceed with the legislated 1.5 percentage point reduction in the federal general corporate income tax rate (taking it to 15 per cent as of January 1, 2012), continue to review and make improvements to capital cost allowance (CCA) rates, and focus on reducing tax administration and compliance costs for businesses.

The federal government must also review the hundreds of exemptions, deductions, rebates, deferrals or credits that are part of the federal tax system to ensure they are cost effective and economically efficient. For example, some credits simply subsidize activities many recipients would have done anyway. Others may stimulate spending in certain areas prompting suppliers to raise prices and, therefore, negate the benefit of the tax credit. In many cases, the government is using tax preferences to achieve social objectives rather than funding the initiative through spending programs. The incentives show up as tax cuts when in fact they are spending increases. Ultimately, the myriad of tax preferences enormously complicate the tax structure, increase compliance costs and open up avenues for evasion and avoidance of tax. Broadening the tax base would facilitate lower tax rates so that everyone benefits.

The Edmonton Chamber of Commerce recommends the Government of Canada stay the course with respect to targets and initiatives announced in last year's federal budget relating to deficit reductions and savings via program spending reviews. However, for the upcoming budget, our members have identified the following three tax initiatives as essentially cost-neutral priorities that would improve business efficiency and profitability and help to ensure the continuation of job creating SMEs:

1. Timely Assessment of Income Tax Returns

Under the Canadian taxation system, taxpayers (individuals, corporations and trusts) are required to file income tax returns and pay income taxes due within time lines clearly set out by the *Income Tax Act* ("the ITA"). If a taxpayer fails to meet the time lines set out by the Act, harsh penalties and interest apply.

On the contrary, the Canada Revenue Agency ("the CRA") is under no set time line to assess a taxpayer's income tax return. Rather, they are only required to assess a taxpayer's return "with all due dispatch", which in practice can mean a few weeks, months or even years.

Having the CRA accountable for timely assessment of returns is important for a number of reasons, including:

- Cash flow – many taxpayers, specifically small business taxpayers, are experiencing some of the most difficult economic times in recent memory and cash flow is key to their economic survival. A delay in assessment delays the taxpayer's ability to recover overpaid tax.

- Refund Interest – recently the rate of interest on corporate refunds of tax was reduced by two percent, whereas the rate of interest on taxes due was not changed. Part of the rationale for this change was that taxpayers were seeking a better rate of return on their cash than they could obtain in the market by overpaying tax. In reality, however, most businesses—in particular small businesses—will earn a better rate of return using their cash in their business.
- Reassessment periods – the period of time the CRA has to reassess a taxpayer is based on their assessment date. If the CRA takes an inordinate amount of time to assess a taxpayer's return, they may also unfairly extend the time of reassessment for the taxpayer.

Recommendation

That the federal government introduce legislation requiring the timely assessment of income tax returns wherein taxpayer's returns are automatically deemed to be assessed as filed (and are duly processed) after 120 days of filing thereby initiating the statute barred period after which reassessment could be issued.

2. Review Wealth Transfer Tax Provisions

As "baby-boomer" Canadians reach retirement age (the first baby-boomers turned age 65 in 2010), it is expected that a significant amount of wealth will be transferred by these individuals to their adult children, spouses, common-law partners or siblings. In some circumstances, certain provisions in the *Income Tax Act* (Canada) (the "ITA") do not accommodate the transfer of wealth in an efficient manner. This is particularly true where business assets are involved in the transfer. As a result, the capital of the business is eroded through the imposition of income taxes thereby reducing profitability and impairing growth, re-investment and, in some situations, jeopardizing the well-being of the business. Given that small business is a significant economic driver it makes sense that tax policies be engineered to facilitate ownership transfers, particularly among family members, rather than jeopardizing their financial well-being.

It is not beneficial for small businesses to face significant challenges on transfer of ownership as this will impair their ability to continue as going concerns.

At present, individual fishers are able to transfer fishing property (including fishing licenses or shares of a fishing corporation) to their children without triggering a tax liability at the time of transfer. A taxpayer may also make an intergenerational transfer of farm property in Canada on an income-tax-deferred rollover basis, if the property was principally used in a farming business in which the taxpayer or a family member was actively engaged on a regular and continuous basis. Similar rules apply to intergenerational transfers of shares of family farm corporations and interests in family farm partnerships.

Examples of transactions that do not transfer wealth efficiently include:

- Division of corporate assets where children have inherited shares from their parents or grandparents;
- Inability to claim the capital gain deduction where children use a corporation to acquire shares in the capital stock of a corporation owned by their parents or grandparents;
- Inability to claim the capital gain deduction where a corporation has retained its profits rather than paying them out as dividends;
- Where property has been sold and some or all of the proceeds from the sale are re-invested in a replacement business or property it can be very difficult for the taxpayer to qualify for the replacement property deferral provisions which seems to defeat the purpose of the provisions;
- Inability to access losses within a related corporate group;

- Reduction to capital losses realized by an estate on disposition of shares where life insurance proceeds are received by a corporation; and
- Inability for common-law partners to divide corporate-owned assets in a tax-effective manner on breakdown of their common-law partnership.

Where it is intended that the business continue as a going concern, preservation of the businesses' capital is a significant concern. Income taxes should not be assessed unless the business has been sold and there are proceeds of disposition available to pay the resulting income taxes. Consider, for example, a situation where children have inherited a business and wish to divide it into separate divisions so that they can run the business independently and to engage in their own estate and succession planning. Unless they can divide all of the assets of the business proportionately, income taxes will be payable as if the assets had been sold at their fair market value. This will impose a significant financial burden on the business and may even threaten its financial well-being. Alternatively, children may decide to carry on the business under the status quo to avoid the income taxes – a situation that is not ideal as it prevents them from being able to engage in their own estate and succession planning independent from their siblings – who may have completely different estate and succession planning ideas, risk tolerances and objectives.

There are provisions in the ITA that provide favourable tax consequences where unrelated parties transact with one another. For example, an individual can claim the capital gain deduction where shares of a small business corporation are sold to a corporation controlled by a third party. However, this is not permissible if the same shares are sold to a corporation controlled by that person's children. This tax policy has the effect of encouraging taxpayers to sell businesses to third parties rather than to their own children. It seems counter intuitive to encourage persons to sell to third parties rather than accommodating families who wish to work together to build wealth and keep a family-owned business in the family.

The capital gain deduction was originally introduced in 1985 and, in its present form, is applicable to the sale of certain business assets and shares of small business, fishing or farming corporations. Unfortunately, to qualify for the capital gain deduction, a corporation must meet certain threshold tests that are complicated for the business owner to understand and do not always makes sense from a policy perspective. For example, the capital gain deduction may be denied where the balance sheet of a corporation consists of non-business assets in addition to business assets. Alternatively, where a corporation takes steps to "purify" its balance sheet by removing non-business assets so that the requisite threshold tests can be met – an anti-avoidance rule may be applicable to tax the purification transaction. This begs the question – why have a capital gain deduction if it is difficult to claim? It makes more sense to amend the threshold provisions so that the portion of gain attributable to the growth in value of business assets (rather than passive investment assets) is eligible for the small business deduction rather than imposing arbitrary and complicated threshold tests that can cause the entire gain to be ineligible.

The above are examples of provisions that appear to be contrary to good tax policy. It seems far more desirable to facilitate the transfer of family-owned businesses to the next generation where they can remain profitable and continue to provide employment, investment in capital structure and pay income taxes on an ongoing rather than one-time basis.

The Edmonton Chamber urges the government to consult on this matter with key stakeholders including taxpayers, academics, tax specialists, government departments such as the Department of Finance and the Department of National Revenue, and professional bodies like the Joint Committee on Taxation, the Canadian Bar Association and the Canadian Institute of Chartered Accountants, as well as review best practices in foreign jurisdictions.

Recommendation

That the federal government undertake a comprehensive review of the tax provisions affecting estate and succession planning in the next 24 months to determine whether the existing tax regime appropriately considers transfer of family-owned businesses.

3. Simplification of the Taxing Statutes

The *Income Tax Act* (Canada) ("ITA"), the *Excise Tax Act* (Canada) ("ETA") and Provincial Corporate Tax Acts (e.g. the *Corporate Tax Act* (Alberta) "CTA") govern the taxation of the majority of transactions entered into by corporations and individuals. These statutes have seen significant amendments since enactment by technical amendments, budgets, Order in Council, income tax conventions, consolidations etc. As a result, these statutes have become difficult for the average business owner, employee or investor to interpret and understand. In some cases, even the professional advisors, the Canada Revenue Agency, the taxpayer and the Courts cannot fully understand the provisions. See, for example, *Hoffman v. H.M.Q.*, 2010 TCC 267 where C. Miller, J. states, at paragraph 13:

> The problem, I suggest, is that the system has become so complicated that not only the taxpayer is bewildered, but also advisors and those administering the Act can likewise scratch their heads wondering which way to turn

In *J.F. Newton Ltd. and John F. Newton v. Thorne Riddell et al., 91 DTC 5726*, Finch, J. of the Supreme Court of British Columbia said, in respect of section 55:

> It surpasses my imagination that anyone considers language such as this to be capable of an intelligent understanding, or that such language is thought to be capable of application to the events of real life, such as the sale of a business.

In submissions to the House of Commons Committee on Finance and Economic Affairs, the Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants stated:

> For any taxpayer to pick up some of this legislation we are looking at here today and understand how these rules are going to impact him when he sits down to fill out his tax return is almost impossible.

Amendments to tax legislation arise as legislators attempt to deal with perceived abuses, changes due to jurisprudence, development of business opportunities not previously available (e.g. electronic commerce) etc. As governments change - new policies and ideas are introduced in the House of Commons and the various Legislative Assemblies eventually accompanied by revised legislation. Over time, it is inevitable that amendments to tax legislation will result in a statute containing a collection of piecemeal amendments, corrections, incentives etc. Legislation will inevitably become more complex, less understandable and more expensive to administer.

As the taxing statutes become more complex, businesses are required to devote an increasing amount of time to compliance matters (i.e. preparing and filing tax returns, information slips, reports etc.). Failure to meet the various compliance obligations can result in the imposition of penalties, interest and additional income or excise taxes in addition to sanctions, increased audit activity all of which results in even more compliance-related reporting.

Examples of complex transactions with high compliance costs include:

- goods and services tax (or harmonized sales tax) administration (real property transactions, joint ventures, multiple jurisdictions)
- unincorporated contractor reporting
- transactions with non-resident persons
- calculation of "safe-income" in corporate reorganizations
- provisions applicable to the sale of a business
- scientific research and experimental development.

A good tax system should be capable of being administered economically and should not impose significant compliance costs on the taxpayers and the governments which administer it. Moreover, the taxing legislation should be clear and simple. The more complicated the legislation, or complex the process, the less likely the system is of being administered efficiently and economically. That being said, it is understood that business transactions are conducted in a sophisticated and uncertain economy and some complexity and uncertainty are unavoidable.

Comprehensive reform of the Canadian federal tax system occurred in 1972 as a result of the recommendations made by the Carter Commission. These reforms resulted in the modern day version of the ITA. In 1987 the federal government introduced its "tax reform" budget containing significant amendments designed to simplify the tax system and make it fair for all taxpayers. Various provincial governments have not introduced tax reform or simplification measures since the CTA was enacted. As there have been many significant amendments and revisions to the taxing statues since the above, a comprehensive review of the same is warranted.

Additionally, as publicly accountable businesses this year complete their transition from Generally Accepted Accounting Principals (GAPP) to the new International Financial Reporting Standards (IFRS) we have another compelling window of opportunity to simplify the ITA to be consistent with these standards and practices and avoid introducing potentially more ambiguity to the taxing statutes.

A review of taxing statutes should include participants from a wide range of key stakeholders including taxpayers, academics, tax specialists, government departments (like Finance Canada and the Canada Revenue Agency) professional bodies (like the Joint Committee on Taxation, the Canadian Bar Association and the Canadian Institute of Chartered Accountants) and foreign governments.

Recommendation

That the federal government establish an expert committee that includes key internal and external stakeholders to, within a 36 month period, undertake a comprehensive review of taxing statutes with the objective of indentifying, recommending and ensuring the implementation of ways and means to simplify tax legislation, reduce compliance costs and ensure all tax payers are treated fairly, and to continuously monitor changes and publicly report progress at least annually.