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Standing Committee on Finance Urged to Stay the Course

On October 27, as part of the Federal Government's pre-budget consultations, Edmonton Chamber of Commerce president and CEO Martin Salloum was once again invited to speak the House of Commons Standing Committee on Finance.

Assisted by James Merkosky, an associate partner in the tax services practice of PricewaterhouseCoopers LLP and volunteer chair of the chamber's Finance and Taxation Committee, Salloum was provided the opportunity to relay our member's most important federal tax and program spending priorities related to the upcoming federal budget.

Given the very tenuous global economic circumstances and to uphold Canada's so far stellar performance and reputation in fiscal management, Salloum stated that the Edmonton Chamber of Commerce members believe it is even more important now that 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.

He pointed out that in pre-budget consultations last year, 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.

He also noted that it is similarly crucial that the progress that has been achieved to-date, with respect to income tax reductions, not be undermined. The Edmonton Chamber of Commerce believes 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) as well as continue to review and make improvements to capital cost allowance (CCA) rates.

However, Salloum told the committee it is with respect to minimizing tax administration and compliance costs that our members have focused their recommendations for this year's federal budget. Adopting three chamber tax policies - Timely Assessment of Income Tax Returns; Reviewing Wealth Transfer Tax Provisions and; Simplification of the Taxing Statutes, would essentially be cost-neutral to the government and yet would improve business efficiency and profitability and help to ensure the continuation of job creating SMEs that are so essential to our economic stability, recovery and growth.

Our recommendations

One:

That the federal government introduced 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, initiating the statute barred period after which reassessment could be issued.

Two:

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.

Three:

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.

APPENDICES

1. Timely Assessment of Income Tax Returns Policy

Under the Canadian taxation system, taxpayers (individuals, corporations and trusts) are required to file income tax returns and pay income taxes due within timelines 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, initiating the statute barred period after which reassessment could be issued.

2. Review Wealth Transfer Tax Provisions Policy

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 reinvested 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 taxeffective 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.

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