



Small Business Deduction

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Background

The current taxation of Canadian Controlled Private Corporations (CCPC's) earning business income is based on a number of premises:

- CCPC's, i.e. "small businesses," are known drivers of growth in employment and the economy as a whole. As such, they are provided with tax incentives to encourage their success and growth. The most significant incentive available is the small business income rate reduction (SBD). The SBD effectively provides a deferral of income tax, so the CCPC has more money to invest in the business. In most provinces, the combined federal and provincial tax deferral can be over \$60,000 if the full SBD limit is used. This deferral of tax provides one source of important financing to privately held companies.
- The 2004 Federal Budget effectively eliminated the Large Corporations Tax (LCT) and increased the base level deduction to \$50 million from \$10 million. This was a very welcome change. However, for the purposes of calculating the SBD limit, the base for calculating LCT and the \$10 million base deduction were still left in place. Once the base deduction for LCT exceeds \$10 million the SBD limit is reduced on a straight-line basis. This reduction is punitive to any corporation that is highly leveraged due to the cost of its products or equipment. The income generated from this business may be identical to a lower leveraged business, but it would not be eligible for any SBD. This unfairly treats corporations that have to have the most capital and therefore could use the benefit of the deferral as a financing source.
- With the introduction of the new dividend regime and the General Rate Income Pool (GRIP) private companies are going to start to retain more profits within the corporation. While this is a positive change it will increase private company's retained earnings. As retained earnings are one of the components of the LCT tax base this will only exaggerate the reduction of the SBD limit.

- The federal government has recognized that the SBD an important incentive by increasing the annual limit. However, by still reducing the eligibility to claim the SBD for companies with a larger capital basis it is penalizing certain sectors.

Recommendations:

That the federal government

1. Eliminate the reduction to the Small Business Deduction for the Large Corporation Tax capital base.